

**COMMONWEALTH OF PUERTO RICO**

Comprehensive Annual Financial Report

Year ended June 30, 2007

# COMMONWEALTH OF PUERTO RICO

## Comprehensive Annual Financial Report

Year ended June 30, 2007

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## **INTRODUCTORY SECTION**



June 15, 2008

The Honorable Governor of Puerto Rico  
Members of the Legislature, and People of Puerto Rico:

It is a pleasure to submit, for your information, the Comprehensive Annual Financial Report (CAFR) of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the fiscal year ended June 30, 2007. This report, presented in three sections, Introductory, Financial, and Statistical, is the primary means of reporting the Commonwealth's financial activities.

The introductory section, which is not audited, includes this letter of transmittal, general information about the Commonwealth, a list of the Commonwealth's principal elected and appointed officials at the balance sheet date, and an organizational chart. The financial section contains the independent auditors' report, management's discussion and analysis (MD&A), and the basic financial statements as listed in the table of contents. The financial section also includes the notes to the basic financial statements, required supplementary information, and other supplementary information. The statistical section, which is not audited, includes selected financial and demographic information, generally presented on a multiyear basis.

#### **Profile of the Commonwealth**

The Puerto Rico Department of the Treasury is responsible for the preparation of this report. The responsibility for the accuracy of presented data and the completeness and fairness of the presentation, including all of the disclosures, rests on the Commonwealth's management. To the best of our knowledge and belief, the following data, as presented, is accurate in all material respects and is presented in a manner designed to set forth the financial position and the results of operations of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth as of June 30, 2007 and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America. We have included all the necessary disclosures to enable the reader to gain a thorough understanding of the Commonwealth's activities.

2 The financial reporting entity includes all funds of the Commonwealth, which comprises the primary government, as well as all its component units. In accordance with Governmental Accounting Standards Board's Statement No. 14, the Commonwealth's financial reporting entity includes 50 component units: 6 are blended component units including 3 fiduciary component units, 8 major discretely presented component units, and 36 nonmajor discretely presented component units. Component units are legally separate entities for which the primary government is financially accountable, or other organizations; the nature and significance of whose relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading and incomplete. Blended component units, although legally separate entities, are, in substance, part of the primary government's operations and are included as part of the primary government. Discretely presented component units, both major and nonmajor, are reported in a separate column in the government-wide financial statements to emphasize that they are not part of the primary government and to differentiate their financial position and results of operations from those of the primary government.

The Honorable Governor of Puerto Rico  
Members of the Legislature, and People of Puerto Rico  
June 15, 2008  
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Generally, each component unit issues audited financial statements, which can be obtained from the component unit's administrative offices. The basic financial statements included in the financial section of this CAFR provide descriptions of the operations of each of the following component units of the Commonwealth:

***Blended Component Units:***

Public Buildings Authority  
Puerto Rico Maritime Shipping Authority  
The Children's Trust

***Discretely Presented Component Units:***

Agricultural Services and Development Administration  
Automobile Accident Compensation Administration  
Cardiovascular Center Corporation of Puerto Rico and the Caribbean  
Caribbean Basin Projects Financing Authority  
Culebra Conservation and Development Authority  
Economic Development Bank for Puerto Rico  
Employment and Training Enterprises Corporation  
Farm Insurance Corporation of Puerto Rico  
Fine Arts Center Corporation  
Governing Board of the 9-1-1 Service  
Government Development Bank for Puerto Rico  
Institute of Puerto Rican Culture  
Institutional Trust of the National Guard of Puerto Rico  
Land Authority of Puerto Rico  
Musical Arts Corporation  
National Parks Company of Puerto Rico  
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives  
Puerto Rico Aqueduct and Sewer Authority  
Puerto Rico Conservatory of Music Corporation  
Puerto Rico Convention Center District Authority  
Puerto Rico Council on Higher Education  
Puerto Rico Electric Power Authority  
Puerto Rico Government Investment Trust Fund  
Puerto Rico Health Insurance Administration  
Puerto Rico Highways and Transportation Authority  
Puerto Rico Industrial Development Company  
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities  
Financing Authority  
Puerto Rico Infrastructure Financing Authority  
Puerto Rico Land Administration  
Puerto Rico Medical Services Administration  
Puerto Rico Metropolitan Bus Authority  
Puerto Rico Municipal Finance Agency  
Puerto Rico Ports Authority

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Puerto Rico Public Broadcasting Corporation  
Puerto Rico Sales Tax Financing Corporation  
Puerto Rico School of Plastic Arts  
Puerto Rico Solid Waste Authority  
Puerto Rico Telephone Authority  
Puerto Rico Tourism Company  
Puerto Rico Trade and Export Company  
Right to Employment Administration  
Special Communities Perpetual Trust  
State Insurance Fund Corporation  
University of Puerto Rico

***Fiduciary Component Units:***

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities  
Puerto Rico Judiciary Retirement System  
Puerto Rico System of Annuities and Pensions for Teachers

**Independent Auditors**

Commonwealth statutes require an annual audit by independent certified public accountants. The firm of KPMG LLP was selected by the Commonwealth to perform the audit of the basic financial statements in accordance with auditing standards generally accepted in the United States of America for the fiscal year 2006 – 2007. The goal of the independent audit was to provide reasonable assurance that the financial statements of the Commonwealth for the fiscal year ended June 30, 2007 are fairly stated in accordance with U.S. generally accepted accounting principles. The independent auditors' report on the basic financial statements is included in the financial section of this report.

**Internal Controls**

The management of the Commonwealth is responsible for establishing and maintaining internal controls to ensure that assets of the Commonwealth are protected from loss, theft, or misuse, and that adequate accounting data is compiled for the preparation of financial statements in conformity with U.S. generally accepted accounting principles. The internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

As a recipient of federal assistance, the Commonwealth is also responsible for ensuring that internal controls are in place to ensure that documents and processes are in compliance with applicable laws and regulations related to such federal financial assistance programs.

Certain departments, agencies, and political subdivisions are subject to the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133. As a result, these entities are audited for compliance with the requirements of the federal financial assistance programs. These audits are performed at the department or agency level. The Commonwealth has provided for the possible cost disallowance that may arise from these audits, as well as from other audits that may be performed by federal grantors.



SECRETARIO DE HACIENDA

### **Budget and Fiscal Policy**

The fiscal year of the Commonwealth begins each July 1. The Governor is constitutionally required to submit to the Legislature an annual balanced budget of capital improvements and operating expenses of the central government for the ensuing fiscal year.

The annual budget is prepared by the Puerto Rico Office of Management and Budget, working with the Puerto Rico Planning Board, the Puerto Rico Department of the Treasury, and other government offices and agencies. Section 7 of Article 6 of the Constitution provides that *"The appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for the said fiscal year unless the imposition of taxes sufficient to cover the said appropriations is provided by law."*

The Commonwealth's budgeted expenditures for fiscal year 2007 of \$9,488 billion exceeded projected revenues of \$9,163 billion by approximately \$325 million. The Commonwealth expected to cover this budget deficit through the implementation of additional expenditure reducing measures, a possible increase in tax revenues resulting from the reduction of the uncertainty surrounding the government's fiscal crisis, and cash management mechanisms. The possible increase in tax revenues was tempered by the adverse economic impact resulting from increases in the price of oil and the implementation of the sales and use tax.

The Commonwealth maintains extensive budgetary controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Legislature. Activities of the general fund are included in the annual appropriated budget. Budgetary control resides at the department level. The Commonwealth also maintains an encumbrance accounting system as one method of maintaining budgetary control.

The annual budget, which is developed using elements of program budgeting, includes an estimate of revenue and other resources for the ensuing fiscal year under laws existing at the time the budget is submitted and legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year investment plan prepared by the Puerto Rico Planning Board.

The Legislature may amend the budget submitted by the Governor, but may not increase items that would cause a deficit without imposing additional taxes to cover such deficit. Once approved by the Legislature, the budget is referred to the Governor, who may decrease or eliminate any item, but may not increase or insert new items in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by a two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, as originally approved by the Legislature and the Governor, it is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This allows the Commonwealth to continue to pay operating and other expenses until a new budget is approved.

### **Governmental Activities**

General governmental activities of the Commonwealth are accounted for in four governmental funds. These funds are: general, special revenue, debt service, and capital project. The general fund is the primary operating fund of the Commonwealth. The general fund is used to account for resources traditionally

associated with government, which are not required legally or by sound financial management to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, education, and economic development. Other major funds are the debt service fund, which accounts for the accumulation of resources predominantly for, and the payment of, the Commonwealth general long-term bonds' principal, interest, and related costs; the Public Buildings Authority capital projects fund, which accounts for the financial resources used for the acquisition and construction of major capital facilities; and The Children's Trust special revenue fund, which accounts for the moneys received by the Commonwealth from a global settlement agreement dated November 23, 1998 between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The financial resources received by this fund are used to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico. Nonmajor governmental funds are combined in a single column in the governmental fund financial statements, and individually identified in the supplementary combining nonmajor governmental funds' financial statements of this report.

#### **Business-Type Activities**

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the government is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where the government has decided that periodic determination of net income is appropriate for accountability purposes.

The Commonwealth's proprietary operations comprise the following activities: the Unemployment Insurance Trust Fund and the Lottery of Puerto Rico and the Additional Lottery System (the Lotteries Fund) and both major funds. The Puerto Rico Water Pollution Control Revolving Fund, the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, the Disability Insurance Fund, and the Drivers' Insurance Fund are all nonmajor proprietary funds combined in a single column in the proprietary fund financial statements, and individually identified in the supplementary combining nonmajor proprietary funds' financial statements of this report.

#### **Fiduciary Operations**

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity or as an agent for individuals, private organizations, and other governmental units. These include the pension trust and agency funds. Pension trust funds are established through trust agreements specifying how the fund will operate. Agency funds are custodial in nature and do not report fund balances. The pension trust funds include the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities, the Puerto Rico Judiciary Retirement System, and the Puerto Rico System of Annuities and Pensions for Teachers.

Agency funds consist of the Special Deposits Fund. This agency fund includes deposits under the custody of the Courts of Justice for alimony payments, deposits under the custody of the Commissioner of Insurance of the Commonwealth for escheated property, and for insurance companies under bankruptcy.



SECRETARIO DE HACIENDA

### **Cash Management Policies and Practices**

The Commonwealth maintains a cash pool for its cash and cash equivalents. The balance in the pooled cash accounts is available to meet current operating requirements and any excess is invested in various interest-bearing accounts in the Government Development Bank for Puerto Rico (GDB), a discretely presented component unit. In addition, the Puerto Rico Government Investment Trust Fund (PRGITF) was created by the Commonwealth pursuant to Act No. 176 of August 11, 1995, and began operations on December 4, 1995. PRGITF is a no-load diversified collective investment trust that was created for the purpose of providing eligible investors with a convenient and economical way to invest in a professionally managed money market portfolio. The deposits on hand and the investments purchased are not collateralized, secured, or guaranteed by the Commonwealth or any of its agencies, instrumentalities, or political subdivisions.

The Commonwealth's investment policy is to minimize credit and market risk while maintaining a competitive yield on its portfolio. The cash temporarily idle during this year was invested mainly in U.S. government securities, stocks, corporate bonds, repurchase agreements, Commonwealth securities other trading securities, and short-term investments. These are primary government investments that are restricted and unrestricted.


### **Capital Assets**

These basic financial statements include the capital assets of the Commonwealth. A discussion of capital assets accounting is included in the MD&A that is part of the basic financial statements. More detailed information about capital assets can be found in the notes to the basic financial statements.

### **Debt Administration**

As of June 30, 2007, the Commonwealth had a number of debt issues outstanding. The Commonwealth has a BBB- credit rating from Standard & Poor's Rating Services and a Baa3 from Moody's Investor Service on general obligation bond issues; these classifications may vary in future years. Section 2 of Article VI of the Constitution of Puerto Rico provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit and taxing power of the Commonwealth shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes issued thereafter, which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenue raised under the provisions of the Commonwealth Legislation and covered into the Treasury of Puerto Rico in the two fiscal years preceding the current fiscal year. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. See the computation of the legal debt margin on page 6 in the statistical section. More detailed information about long-term debt can be found in the notes to the basic financial statements.

### **Risk Financing**

 The Commonwealth purchases commercial insurance to cover casualty, theft, tort claims, and other losses. The current insurance policies have not been canceled or terminated. As it relates to workers' compensation, the Commonwealth's discretely presented component unit, the State Insurance Fund Corporation, provides workers' compensation to both public and private employees.

### **Financial Advisor and Fiscal Agent**

The principal functions of GDB are to act as financial advisor to and fiscal agent for the Commonwealth, its municipalities, and public corporations, in connection with the issuance of bonds and notes, and to make loans to private enterprises to aid the economic development of Puerto Rico.

### **Economic Conditions and Outlook**

The economy of Puerto Rico is closely linked to the U.S. economy. The following exogenous variables are affected by the U.S. economy: exports, direct investment, transfer payments, interest rates, inflation, and tourist expenditures.

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. Manufacturing is the largest sector in terms of gross domestic product. Manufacturing in Puerto Rico is now more diversified than during the earlier phases of its industrial development and includes several industries less prone to business cycles. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor.

The services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism, and other services, has shown a strong interaction with manufacturing, tourism, construction, and agriculture.

Tourism makes a significant contribution to economic activity. An estimated \$3.4 billion were spent by visitors in Puerto Rico during fiscal year 2007. San Juan has become the largest home port for cruise ships in the Caribbean and the fourth largest home port for cruise ships in the world. During the fiscal year 2007, the number of visitors increased 0.8% compared with fiscal year 2006. The construction sector is an integral part of the economic activity from fiscal year 1999 through fiscal year 2007. Puerto Rico is heavily dependent on oil imports for the production of electricity; however, as a result of the construction of two cogeneration plants, one of which is fueled by liquefied natural gas and the other by coal, Puerto Rico's dependence on oil imports for the production of electricity has been reduced from 99.0% to 74.0%. Currently, as part of the Puerto Rico Electric Power Authority's capital improvement plan, the Puerto Rico Electric Power Authority is considering building an additional cogeneration power plant fueled by liquefied natural gas in the municipality of Mayagüez.

The Puerto Rico Planning Board's preliminary reports of the performance of the Puerto Rico economy during fiscal year 2007 indicate that the economy registered a decrease of 1.8% in total real gross product. Gross product in fiscal year 2000 was \$41.4 billion and gross product in fiscal year 2007 was \$58.7 billion. This represents an increase in gross product of 42.0% from fiscal year 2000 to fiscal year 2007.

A In terms of personal income, in fiscal year 2007, personal income per capita was \$13,491 compared to \$13,033 in 2006 and \$10,204 in 2000.

According to the Puerto Rico Department of Labor and Human Resources, during fiscal year 2007, the labor force was 1.41 million compared to 1.42 million in fiscal year 2006. The average unemployment rate decreased from 11.7% during fiscal year 2006 to 10.4% in fiscal year 2007.



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## **Major Initiatives**

### ***Tax Regime for Companies Doing Business in Puerto Rico***

In order to enhance the desirability for U.S. companies to establish operations in Puerto Rico, after the elimination of Section 936 of the U.S. Internal Revenue Code (IRC), the Commonwealth has tried different efforts to improve its tax treatment to foreign companies. It pursued an amendment to Section 956 of the IRC during 2001 to 2003, and it introduced several changes to the tax incentive law of 1997. Also, during May 2008, the Commonwealth approved a new tax incentive law. All these efforts are expected to advance the manufacturing sector, which has a great impact on the rest of the economic activity.

### ***Public Sector Debt***

Historically, the Commonwealth has maintained, as a matter of fiscal policy, a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. During certain fiscal years, however, public sector debt increased at a greater rate than the rate of gross product primarily due to an increase in the amount of debt incurred to finance certain key infrastructure projects, which are important to the development of the economy and are expected to produce long-term economic benefits, and debt incurred to refinance outstanding debt to enable Puerto Rico to benefit from the historically low levels of interest rates and realize debt service savings. During fiscal year 2007, public sector debt increased 7.22%.

### ***Prospects for the Future***

The Commonwealth is committed to research and pursue solutions to improve the Commonwealth's competitive economic performance and the quality of life for its people. The Commonwealth's economic development program is focused on initiatives aimed at producing more diversified and sustainable economic development. The six principal elements of these initiatives, as expressed in the Governor's Economic Development and Government Transformation Plan for Puerto Rico, are the following: (i) developing world-class infrastructure, while encouraging private investment with innovative financial models and agile, effective evaluation processes; (ii) accelerating Puerto Rico's entry into the knowledge economy by creating a center of excellence in biotechnology, engineering and computing; (iii) promoting local enterprise and supporting local businesses (in Spanish, Apoyo al de Aquí) by providing innovative financing alternatives and access to domestic and foreign markets; (iv) transforming the tourist industry into a vehicle for Puerto Rico's economic development; (v) diversifying energy-generating sources to reduce dependence on petroleum by half; and (vi) transforming Puerto Rico's government, without the need for layoffs or privatization, through effective agency consolidation and decentralization functions to offer first-class services to all citizens in a sensible, effective and agile manner and to contribute to Puerto Rico's socio-economic development. subsidies provided to governmental entities; and (5) refocused strategic projects related to the citizen's health.

*AS*

The tax reform which is in force since November 15, 2006 replaced the Commonwealth's general excise tax (5%) with the sales and use tax. This new tax regime included compensatory income tax credits in order to address any regressive effect that the consumption tax may have and eliminated the marriage penalty, beginning with the tax year 2008. The Puerto Rico Department of the Treasury expects that the tax reform will provide a net increase in the general fund's annual revenues, after taking into consideration projected reductions in income taxes, in an amount sufficient to reduce and eventually eliminate the structural budget imbalance.

The proposed fiscal reform includes a long-term plan to reduce and improve the management of the Commonwealth's public debt. Upon the elimination of the structural budget imbalance, which elimination must be certified to the Legislative Assembly and the Governor by the Secretary of the Treasury, the Director of OMB, and the President of GDB, the Commonwealth's operating budget will include an annual contribution to the public improvement fund equal to 2% of the total amount of the public improvement bonds authorized for that fiscal year. The annual contribution to the public improvement fund will increase by an additional 2% of the then-current authorization for each fiscal year thereafter, up to a maximum of 20% of the current year's authorized public improvement bond issuance. This contribution is intended to reduce proportionally each year the amount of the Commonwealth's public improvement bond issues.

The Commonwealth faces other fiscal challenges besides its current budgetary issues. The principal one involves resolving the increasing unfunded pension liability of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (Employees' Retirement System) and the Puerto Rico System of Annuities and Pensions for Teachers (the Teachers Retirement System). The Commonwealth expects to reduce the unfunded liability of the Employees' Retirement System based on proposed legislation, which provides for increased employer and employee contributions and the issuance of up to \$2 billion of pension obligation bonds, which would be payable from the Commonwealth's general fund. Besides, the Employees' Retirement System is considering an issue of bonds to improve unfunded pension liability of the fund. The Employees' Retirement System and the Teachers Retirement System are also seeking reimbursement from the Commonwealth for certain special retirement benefits paid by them in prior fiscal years under legislation providing such retirement benefits.

### **Financial Condition**

The MD&A, which can be found immediately following the independent auditors' report, provides an overview of the Commonwealth's financial activities addressing both governmental and business-type activities reported in the governmentwide financial statements. In addition, the MD&A focuses on the Commonwealth's major funds. Component units and fiduciary activities are excluded from the MD&A.

### ***Estimated Fiscal Year 2008 Compared to Actual Fiscal Year 2007***

As revised, estimated general fund total revenue for fiscal year 2008 is \$8.821 billion, representing a decrease of \$41.5 million from fiscal year 2007 revenue. The 2007 revenue projections and subsequent revision take into account (i) the Puerto Rico Planning Board's downward revision of its forecast for real growth in gross national product from 0.6% to 1.8%, (ii) the substitution of the sales and use tax for the 5.0% general excise tax, and (iii) certain income tax rate reductions included in the tax reform legislation of 2006.

### **Other Information**

#### ***Acknowledgements***

A The preparation of this report requires the collective efforts of numerous finance personnel throughout the Commonwealth and is made possible only with the cooperation and support of the Executive, Legislative, and Judicial branch agencies, and component units of the Commonwealth. We sincerely appreciate the dedicated efforts of all these individuals.

The report could not have been accomplished without the professionalism and dedication of Juan B. Torr  Mart nez, CPA, from our accounting team as well as the rest of the personnel of the Central Government



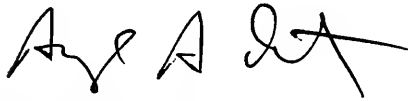
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Accounting area. Also, we would like to give special thanks to our independent auditors, KPMG LLP, for their advice and commitment.

This report continues our commitment to the people of the Commonwealth of Puerto Rico, the Governor, the Legislature, and the financial community to maintain our basic financial statements in conformance with the highest standards of financial accountability.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Angel A. Garcia', with a stylized flourish at the end.

Angel Ortiz García  
Acting Secretary of the Treasury

# COMMONWEALTH OF PUERTO RICO

## PRINCIPAL OFFICIALS

**Aníbal Acevedo Vilá**  
Governor

Members of Cabinet

**Jorge P. Silva Puras**  
Chief of Staff

**Fernando J. Bonilla Ortiz**  
Secretary of State

**Roberto J. Sánchez Ramos**  
Secretary of Justice

**Ángel Ortiz García**  
Acting Secretary of the  
Treasury

**Rafael Aragunde Torres**  
Secretary of Education

**Román Velasco González**  
Secretary of Labor and Human Resources

**Rosa Pérez Perdomo**  
Secretary of Health

**Gabriel Figueroa Herrera**  
Secretary of Agriculture

**Carlos González Miranda**  
Secretary of Transportation and  
Public Works

**Bartolomé Gamundi Cestero**  
Secretary of Economic  
Development and Commerce

**Félix Matos Rodríguez**  
Secretary of Family Affairs

**Jorge Rivera Jiménez**  
Secretary of Housing

**Javier Vélez Arocho**  
Secretary of Natural and  
Environmental Resources

**Víctor A. Suárez Meléndez**  
Secretary of Consumer Affairs

**David E. Bernier Rivera**  
Secretary of Sports and Recreation

**Miguel A. Pereira Castillo**  
Secretary of Corrections and  
Rehabilitation

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## LEGISLATIVES OFFICERS

**Kenneth D. McClintock Hernández**  
President, Senate

**José F. Aponte Hernández**  
Speaker, House of Representatives

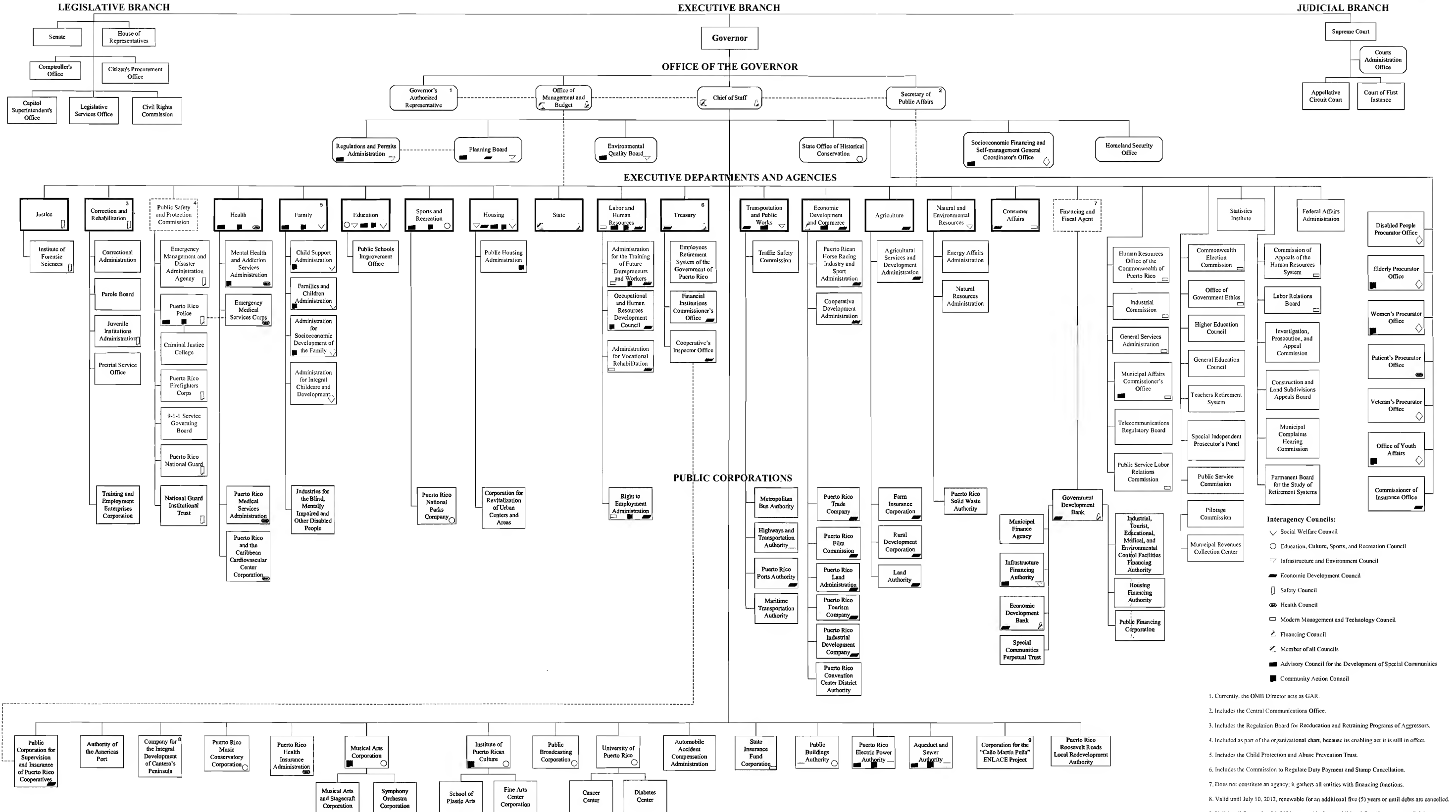
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## FISCAL OFFICERS

**Armando A. Valdés Prieto**  
Director, Office of Management and  
Budget

**Jorge Irizarry Herrans**  
President, Government  
Development Bank for Puerto  
Rico

COMMONWEALTH OF PUERTO RICO  
FUNCTIONAL ORGANIZATIONAL STRUCTURE



1. Currently, the OMB Director acts as GAR.  
2. Includes the Central Communications Office.  
3. Includes the Regulation Board for Receducation and Retraining Programs of Aggressors.  
4. Included as part of the organizational chart, because its enabling act it is still in effect.  
5. Includes the Child Protection and Abuse Prevention Trust.  
6. Includes the Commission to Regulate Duty Payment and Stamp Cancellation.  
7. Does not constitute an agency; it gathers all entities with financing functions.  
8. Valid until July 10, 2012, renewable for an additional five (5) years or until debts are cancelled.  
9. Valid until September 24, 2024, renewable for an additional five (5) years or until debts are cancelled.

## **FINANCIAL SECTION**

## **Independent Auditors' Report**

The Honorable Governor and Legislature of the  
Commonwealth of Puerto Rico  
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the year ended June 30, 2007, which collectively comprise the Commonwealth's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commonwealth's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Public Buildings Authority capital project fund or The Children's Trust special revenue fund (major funds), which represents 1% and 0%, respectively, of the assets and revenue of the government activities. We also did not audit the financial statements of the following activities, funds, and component units:

- Puerto Rico Public Housing Administration, the Office for the Improvements of Public Schools, Human Resources and Occupational Development Council, and the Office for the Administration of the Assets of the Urban Renovation and Housing Corporation of the Commonwealth of Puerto Rico, which collectively represent 17% and 3%, respectively, of the assets and revenue of the general fund and 6% and 5%, respectively, of the assets and revenue of the governmental activities,
- The Additional Lottery System, which represents 68% and 39%, respectively, of the assets and revenue of the lotteries fund and 13% and 29%, respectively, of the assets and revenue of the business-type activities;
- Public Buildings Authority special revenue and debt service funds, which collectively represent 5% and 1%, respectively, of the assets and revenue of the aggregate remaining fund information and 3% and 0%, respectively, of the assets and revenue of the governmental activities;
- The pension trust funds, which represents 74% and 93%, respectively, of the assets and revenue of the aggregate remaining fund information; and
- Entities identified in note 2 that are presented as discretely presented component units, which collectively represent 87% and 90%, respectively, of the assets and revenue of the aggregate discretely presented component units.

These financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the activities, funds, and component units indicated above, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Commonwealth's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico as of June 30, 2007, and the respective changes in financial position, and, where applicable, cash flows thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 3 through 20 and the schedule of funding progress on pages 154 through 155 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The combining and individual fund financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. These financial statements and combining schedules have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections of this report listed in the table of contents have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

KPMG LLP

June 15, 2008

Stamp No. 2222539 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO**  
Management's Discussion and Analysis (Unaudited)  
June 30, 2007

Management of the Commonwealth of Puerto Rico (the Commonwealth) provides this Management's Discussion and Analysis for the readers of the Commonwealth's basic financial statements. This narrative overview and analysis of the financial activities of the Commonwealth is for the fiscal year ended June 30, 2007, and is intended to provide an easily readable explanation of the information provided in the attached basic financial statements. We encourage readers to consider this information with the Commonwealth's basic financial statements that follow.

**Financial Highlights – Primary Government**

***Government-wide Highlights***

- The Commonwealth reported a deficit of \$17.7 billion as of June 30, 2007, a deterioration in the financial position of \$1.3 billion from last year's balances. The accumulated deficit is principally the result of the Commonwealth's practice of issuing debt and transferring such funds to its discretely presented component units in order for them to carry out the corresponding construction programs and to borrowings made by the primary government of the Commonwealth to cover operational needs.
- The Commonwealth's total deficit increased by \$1.3 billion (a 8% increase) as a result of this year's operations. The governmental activities' deficit increased by \$1.2 billion (a 7% increase), while net assets of the business-type activities showed a decrease of \$20 million (an 3% decrease).
- The Commonwealth's governmental activities had total revenue of \$15.1 billion, which were exceeded by total expenses of \$16.7 billion, excluding transfers received from business-type activities amounting to \$343 million.
- The Commonwealth's business-type activities had total revenue of \$1.5 billion, which exceeded total expenses of \$899 million, excluding transfers made to the governmental activities amounting to \$343 million.

***Fund Highlights***

- As of June 30, 2007, the Commonwealth's governmental funds reported a combined ending fund balance of \$107 million, a decrease of \$304 million in comparison with the prior year, while the business-type activities decreased by \$20 million to reach \$757 million.
- The general fund reported a deficit of \$511 million as of June 30, 2007, an increase of \$127 million in comparison with the prior year.
- The unemployment insurance trust fund reported net assets of \$459 million while the lotteries fund reported a deficit of \$153 million. The deficit in the lottery funds was a result of the transfers of investments made to the general fund a few years ago.

***Long-Term Debt***

- Total long-term obligations as of June 30, 2007 were \$28 billion, from which \$2 billion are due within one year. The long-term obligation of the governmental activities increased by \$1 billion (4%) to \$28 billion when compared to the prior year, while the business-type activities decreased by \$26 million

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(7%) to \$356 million. The increase in governmental activities' long-term obligations was mainly due to borrowings made by the Department of the Treasury of the Commonwealth to cover operational needs.

**Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to the Commonwealth's basic financial statements. The Commonwealth's basic financial statements include three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains additional required supplementary information in addition to the basic financial statements themselves. These components are described below:

***Basic Financial Statements***

The basic financial statements include two kinds of financial statements that present different views of the Commonwealth—the government-wide financial statements and the fund financial statements and combining major component units financial statements. These financial statements also include the notes to the basic financial statements that explain some of the information in the financial statements and provide more detail.

**Government-wide Financial Statements**

The government-wide financial statements provide a broad view of the Commonwealth's operations in a manner similar to a private sector business. The statements provide both short- and long-term information about the Commonwealth's financial position, which assists in assessing the Commonwealth's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenue and expenses connected with the fiscal year even if cash involved has not been received or paid. The government-wide financial statements include two statements:

- ***Statement of Net Assets*** – This presents all of the government's assets and liabilities with the difference between the two reported as net assets (deficit). Over time, increases or decreases in the Commonwealth's net assets (deficit) may serve as a useful indicator of whether the financial position of the Commonwealth is improving or deteriorating.
- ***Statement of Activities*** – This presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenue and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenue for each function of the Commonwealth.

Both of the above financial statements have separate sections for three different types of Commonwealth programs or activities. These three types of activities are as follows:

- ***Governmental Activities*** – The activities in this section are mostly supported by taxes and intergovernmental revenue (federal grants). Most services normally associated with Commonwealth government fall into this category, including general government, public safety, health, public housing and welfare, education, and economic development.

## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis (Unaudited)

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- ***Business-Type Activities*** – These functions normally are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. These business-type activities of the Commonwealth include the operations of the following major funds: unemployment insurance trust fund (administered by the Commonwealth Employment Security Bureau) and the lotteries.

- ***Component Units*** – These are organizations that are legally separate from the Commonwealth, but either the Commonwealth is financially accountable for them or the nature and significance of their relationship with the Commonwealth are such that their exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. The Commonwealth has both blended and discretely presented component units.

- ***Blended Component Units*** – Although legally separate entities, these are in substance part of the primary government's operations. Therefore, data from blended component units are integrated into the appropriate funds for reporting purposes.

The Commonwealth's three blended component units are:

- Public Buildings Authority
- Puerto Rico Maritime Shipping Authority
- The Children's Trust

- ***Discretely Presented Component Units*** – These are operations for which the Commonwealth has financial accountability, but they have certain independent qualities as well. For the most part, these entities operate similar to private sector businesses and the business-type activities described above. The Commonwealth's discretely presented component units are presented in two categories, major and nonmajor. This separation is determined by the relative size of the entities' assets, liabilities, revenue, and expenses in relation to the total of all component units.

The Commonwealth's 36 discretely presented nonmajor component units are combined into a single column for reporting in the fund financial statements. Complete financial statements of the individual component units can be obtained from their respective administrative offices. Addresses and other additional information about the Commonwealth's component units are presented in note 1 to the basic financial statements.

The Commonwealth's eight discretely presented major component units are:

- Government Development Bank for Puerto Rico
- Puerto Rico Highways and Transportation Authority
- Puerto Rico Electric Power Authority
- Puerto Rico Aqueduct and Sewer Authority

## COMMONWEALTH OF PUERTO RICO

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- Puerto Rico Infrastructure Financing Authority
- Puerto Rico Health Insurance Administration
- Puerto Rico Sales Tax Financing Corporation
- University of Puerto Rico

The government-wide financial statements can be found immediately following this discussion and analysis.

#### **Fund Financial Statements**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other states and local governments, uses fund accounting to help ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements focus on individual parts of the Commonwealth government, reporting the Commonwealth's operations in more detail than the government-wide financial statements. All of the funds of the Commonwealth can be divided into three categories. It is important to note that these fund categories use different accounting approaches and should be interpreted differently. The three categories of funds are the following:

- ***Governmental Funds Financial Statements*** – Most of the basic services provided by the Commonwealth are financed through governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating the government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified-accrual basis of accounting. These statements provide a detailed short-term view of the Commonwealth's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Commonwealth. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenue, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities. These reconciliations are presented on the page immediately following each governmental fund financial statement.

The Commonwealth has four major governmental funds. That is, each major fund is presented in a separate column in the governmental funds balance sheet and in the governmental funds statement of revenue, expenditures, and changes in fund balances. The Commonwealth's four major governmental funds are the general fund, The Children's Trust special revenue fund, the debt service fund, and the Public Buildings Authority capital projects fund. The remaining nonmajor governmental funds are grouped and presented in a single column in the governmental funds

## COMMONWEALTH OF PUERTO RICO

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financial statements. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

- ***Proprietary Funds Financial Statements*** – These funds are used to show activities that operate more like those of commercial enterprises. Because these funds charge fees for services provided to outside customers including local governments, they are known as enterprise funds. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. Like the government-wide financial statements, proprietary fund financial statements use the accrual basis of accounting. There is no reconciliation needed between the government-wide financial statements for business-type activities and the proprietary fund financial statements. The Commonwealth has two major enterprise funds. As previously mentioned, they are the operations of the unemployment insurance trust fund (administered by the Commonwealth's Employment Security Bureau) and the lotteries. Other nonmajor proprietary funds are grouped and presented in a separate column in the proprietary funds financial statements. The basic proprietary funds financial statements can be found immediately following the governmental fund financial statements.

- ***Fiduciary Funds and Similar Component Units Financial Statements*** – These funds are used to account for resources held for the benefit of parties outside the Commonwealth government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the Commonwealth's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. They use the accrual basis of accounting. The Commonwealth's fiduciary funds are the pension trust funds (three separate retirement systems for employees, which are fiduciary component units of the Commonwealth) and the agency funds (which account for the assets held for distribution by the Commonwealth as an agent for other governmental units, other organizations, or individuals). The basic fiduciary funds and similar component units' financial statements can be found immediately following the proprietary funds financial statements.

#### **Component Units Financial Statements**

As mentioned above, these are operations for which the Commonwealth has financial accountability, but they have certain independent qualities as well, and they operate similar to private sector businesses. The government-wide financial statements present information for the component units in a single column on the statement of net assets. Also, some information on the statement of changes in net assets is aggregated for component units. The combining statements of net assets and the combining statement of activities provide detail for each major component unit and the nonmajor component units in aggregate. The basic combining financial statements for major component units can be found immediately following the fiduciary funds financial statements.

#### **Notes to Basic Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the component units' financial statements.

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**Required Supplementary Information**

The basic financial statements include within its notes a section of required supplementary information. This section includes information of funding progress for the Commonwealth's three separate retirement systems.

**Government-Wide Financial Analysis**

*Net Assets*

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. Total assets and total liabilities of the Commonwealth's primary government at June 30, 2007 amounted to \$14.6 billion and \$32.3 billion, respectively, for a net deficit of \$17.7 billion, compared to a \$16.4 billion net deficit at the beginning of the current year, as restated.

A portion of the Commonwealth's net assets (deficit) reflects its investment in capital assets such as land, buildings, and equipment, less any related debt used to acquire those assets that are still outstanding. The Commonwealth uses these capital assets to provide services to its residents; consequentially, these assets are not available for future spending. Although the Commonwealth's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Commonwealth's net assets (deficit) represents resources that are subject to external restrictions on how they may be used. An otherwise positive remaining balance would be used to meet the Commonwealth's ongoing obligations to its residents and creditors. Internally imposed designations of resources are not presented as restricted net assets. At the end of the current fiscal year, the Commonwealth is able to report positive balances in two categories of net assets, and a deficit, both for the government as a whole as well as for its separate governmental and business-type activities.

As explained earlier, the net deficit of the primary government primarily results from the Commonwealth's practice of issuing debt and transferring such funds to the component units so that they can carry out the construction projects. The primary government retains the debt while the component units report the corresponding asset financed by such debt.

Total assets decreased by \$248 million during fiscal year 2007 when compared to the prior fiscal year. This decrease is the net effect of various increases and decreases as follows:

- Unrestricted and restricted cash decreased by \$1.1 billion when compared to the prior year. The decrease was mainly due to an increase of approximately \$922 million in expenditures when compared to the prior year.
- Net increase of \$535 million in the receivables was mainly due to the timing of cash collections when compared to prior year.
- Additions to capital assets, retirements, and depreciation expense amounted to approximately \$478 million, \$54 million, and \$236 million, respectively.

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Total liabilities increased \$989 million during the current fiscal year when compared to the prior fiscal year. This fluctuation is mainly prompted by the issuance during fiscal year 2007 of Commonwealth's bonds amounting to \$1.1 billion and an increase in the liabilities associated with compensated absences and legal claims totaling \$1 billion and \$175 million, respectively. The latter were offset by repayments of bonds of \$303 million, compensated absences of \$966 million and legal claims of \$26 million.

### Commonwealth's Net Assets – Primary Government

June 30, 2007

(Expressed in thousands)

	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
Current assets	\$ 3,658,200	849,289	4,507,489
Capital assets	7,407,848	674	7,408,522
Other assets	2,389,190	297,636	2,686,826
<b>Total assets</b>	<b>\$ 13,455,238</b>	<b>1,147,599</b>	<b>14,602,837</b>
Current liabilities	\$ 6,658,987	151,299	6,810,286
Noncurrent liabilities	25,235,145	238,965	25,474,110
<b>Total liabilities</b>	<b>\$ 31,894,132</b>	<b>390,264</b>	<b>32,284,396</b>
Invested in capital assets, net of related debt	\$ 3,635,271	674	3,635,945
Restricted	331,051	910,479	1,241,530
Unrestricted	(22,405,216)	(153,818)	(22,559,034)
<b>Total net assets (deficit)</b>	<b>\$ (18,438,894)</b>	<b>757,335</b>	<b>(17,681,559)</b>

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**Commonwealth's Net Assets – Primary Government**

June 30, 2006

(Expressed in thousands)

	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
Current assets	\$ 3,665,245	939,895	4,605,140
Capital assets	7,183,178	1,008	7,184,186
Other assets	2,817,053	255,993	3,073,046
Total assets	<u>\$ 13,665,476</u>	<u>1,196,896</u>	<u>14,862,372</u>
Current liabilities	\$ 6,378,707	149,673	6,528,380
Noncurrent liabilities	24,496,332	269,723	24,766,055
Total liabilities	<u>\$ 30,875,039</u>	<u>419,396</u>	<u>31,294,435</u>
Invested in capital assets, net of related debt	\$ 3,485,882	1,008	3,486,890
Restricted	280,078	947,507	1,227,585
Unrestricted	(20,975,523)	(171,015)	(21,146,538)
Total net assets (deficit)	<u>\$ (17,209,563)</u>	<u>777,500</u>	<u>(16,432,063)</u>

The net assets of the governmental activities as of June 30, 2006 were restated by \$14.7 million as a result of an underestimation of capital assets.

***Changes in Net Assets***

The Commonwealth's net deficit increased by \$1.3 billion or 8% from last year's total net deficit. Approximately 52% of the Commonwealth's total revenue came from taxes, while 32% resulted from grants and contributions (primarily federal financial assistance). Charges for various goods and services provided represented 12% of the total revenue. The Commonwealth's expenses cover a range of services. The largest expenses were for education, public housing and welfare, public safety, and general government. In 2007, governmental activities' expenses exceeded program revenue by \$11 billion, resulting in the use of \$9.6 billion in general revenue (mostly taxes) and transfers. On the other hand, program revenue from business-type activities in 2007 exceeded expenses by approximately \$285 million. Total governmental activities' expenses increased by \$922 million when compared with 2006. Such increase was due to the effect of increases in expenses incurred in 2007 to fulfill the requirements of federal government grants and contributions in 2007 which increased by \$548 million and normal increases in costs of goods and services. In addition, the business-type activities had unrestricted investments earnings of \$37 million and transfer to the governmental activities amounting to \$342 million.

Governmental activities increased the Commonwealth's net deficit by \$1.2 billion. The Commonwealth implemented the sales and use tax during fiscal year 2007. This sales and use tax resulted in higher tax revenues. The Commonwealth expects that the effort to decrease expenses and the increase in tax revenue with the sales and use tax will eliminate or significantly lower the deficit in future years.

Business-type activities decreased the Commonwealth's net assets by \$20 million.



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**Commonwealth of Puerto Rico's Changes in Net Assets – Primary Government**

Year ended June 30, 2007

(Expressed in thousands)

	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
Revenue:			
Program revenue:			
Charges for services	\$ 757,724	1,140,539	1,898,263
Operating grants and contributions	4,773,174	43,480	4,816,654
Capital grants and contributions	257,514	—	257,514
	<u>5,788,412</u>	<u>1,184,019</u>	<u>6,972,431</u>
General revenue:			
Income taxes	6,488,211	—	6,488,211
Excise taxes	1,475,311	—	1,475,311
Sales and use tax	583,639	—	583,639
Other taxes	4,663	—	4,663
Revenue from component units	381,336	—	381,336
Other	383,777	37,177	420,954
	<u>9,316,937</u>	<u>37,177</u>	<u>9,354,114</u>
Total revenue	<u>15,105,349</u>	<u>1,221,196</u>	<u>16,326,545</u>
Expenses:			
General government	2,847,596	—	2,847,596
Public safety	1,983,782	—	1,983,782
Health	1,943,582	—	1,943,582
Public housing and welfare	3,157,877	—	3,157,877
Education	4,748,008	—	4,748,008
Economic development	554,271	—	554,271
Intergovernmental	593,264	—	593,264
Interest and other	863,723	26,860	890,583
Lotteries	—	679,274	679,274
Unemployment	—	192,484	192,484
Total expenses	<u>16,692,103</u>	<u>898,618</u>	<u>17,590,721</u>
(Decrease) increase in net assets before transfers	(1,586,754)	322,578	(1,264,176)
Transfers	<u>342,743</u>	<u>(342,743)</u>	<u>—</u>
(Decrease) increase in net assets	(1,244,011)	(20,165)	(1,264,176)
Net assets (deficit), beginning of year (as restated)	<u>(17,194,883)</u>	<u>777,500</u>	<u>(16,417,383)</u>
Net assets (deficit), end of year	<u>\$ (18,438,894)</u>	<u>757,335</u>	<u>(17,681,559)</u>

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**Commonwealth of Puerto Rico's Changes in Net Assets – Primary Government**

Year ended June 30, 2006

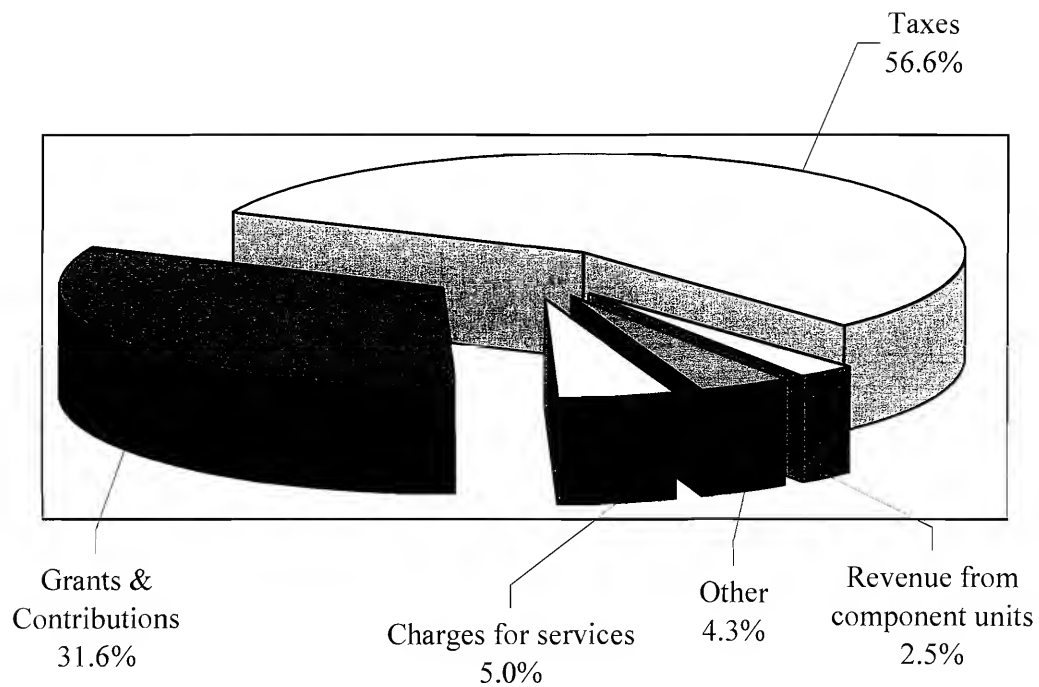
(Expressed in thousands)

	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
Revenue:			
Program revenue:			
Charges for services	\$ 828,993	1,149,426	1,978,419
Operating grants and contributions	4,365,711	59,613	4,425,324
Capital grants and contributions	100,990	—	100,990
	<u>5,295,694</u>	<u>1,209,039</u>	<u>6,504,733</u>
General revenue:			
Income taxes	6,255,391	—	6,255,391
Excise taxes	2,013,998	—	2,013,998
Other taxes	15,145	—	15,145
Revenue from component units	68,745	—	68,745
Other	601,225	33,165	634,390
	<u>8,954,504</u>	<u>33,165</u>	<u>8,987,669</u>
Total revenue	<u>14,250,198</u>	<u>1,242,204</u>	<u>15,492,402</u>
Expenses:			
General government	2,844,494	—	2,844,494
Public safety	2,217,294	—	2,217,294
Health	1,422,813	—	1,422,813
Public housing and welfare	3,287,559	—	3,287,559
Education	4,110,669	—	4,110,669
Economic development	564,447	—	564,447
Intergovernmental	440,390	—	440,390
Interest and other	882,163	25,043	907,206
Lotteries	—	670,425	670,425
Unemployment	—	207,483	207,483
Total expenses	<u>15,769,829</u>	<u>902,951</u>	<u>16,672,780</u>
(Decrease) increase in net assets before transfers	(1,519,631)	339,253	(1,180,378)
Transfers	242,642	(242,642)	—
(Decrease) increase in net assets	(1,276,989)	96,611	(1,180,378)
Net assets (deficit), beginning of year	(15,932,574)	680,889	(15,251,685)
Net assets (deficit), end of year	<u>\$ (17,209,563)</u>	<u>777,500</u>	<u>(16,432,063)</u>

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**Revenue – Governmental Activities**

Year ended June 30, 2007



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**Governmental Activities**

Governmental activities increased the Commonwealth's net deficit to \$18.4 billion. The decrease in net assets by the business-type activities is explained below. A comparison of the cost of services by function for the Commonwealth's governmental activities is shown below, along with the revenue used to cover the net expenses of the governmental activities (expressed in thousands).

**Governmental Activities – Expenses Net of Program Revenue**

Year ended June 30, 2007

(Expressed in thousands)

Net expense:	
General government	\$ (2,274,426)
Public safety	(1,849,517)
Health	(1,081,383)
Public housing and welfare	(498,877)
Education	(3,269,028)
Economic development	(473,473)
Intergovernmental	(593,264)
Interest and other	<u>(863,723)</u>
Total governmental activities expenses, net program revenue	(10,903,691)
General revenue:	
Taxes	8,551,824
Revenue from component units	381,336
Transfers from business-type activities	342,743
Other revenue	<u>383,777</u>
Increase in governmental activities' net deficit	<u><u>\$ (1,244,011)</u></u>

***Business-Type Activities***

The business-type activities decreased the Commonwealth's net assets by \$20 million. This resulted from the decrease of approximately \$20 million in contributions from federal government when compared to prior year.

***Financial Analysis of the Commonwealth's Individual Funds***

As noted earlier, the Commonwealth uses fund accounting to help ensure and demonstrate compliance with finance-related legal requirements.

## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis (Unaudited)

June 30, 2007

#### ***Governmental Funds***

The focus of the Commonwealth's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Commonwealth's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. As of the end of fiscal year 2007, the Commonwealth's governmental funds reported combined ending fund balance of \$107 million, a decrease of net assets of \$304 million in comparison with the prior year. The expenditures exceeded the revenues by \$2.2 billion. However, this was offset by other financing sources amounting to \$1.9 billion in the fund balance of the governmental funds. This year, the excess of expenditures over revenue increased by \$368 million compared with the prior year. There is \$993 million of fund balance reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate contracts and purchase orders of the prior fiscal year or (2) for a variety of other restricted purposes.

The general fund is the chief operating fund of the Commonwealth. At the end of the current fiscal year, unreserved fund deficit of the general fund was \$1.5 billion, while the total fund balance has a total deficit of \$511 million. The fund deficit of the Commonwealth's general fund increased by \$127 million as a result of the current fiscal year's change in financial position. This is a 33% increase when compared to total fund balance reported in fiscal year 2006. Also, see additional related comments in the following section titled general fund budgetary highlights.

The debt service fund is the fund in which the Commonwealth accumulates the resources for the payment of the long-term debt. At end of the year, the fund balance of the debt service fund decreased by \$20.7 million. Bonds and interest payable increased by \$22 million or 6% compared with the prior year mainly due to the accumulation of resources for the payment of debt.

The PBA capital projects fund received resources only from transfers from other funds amounting to \$146 million and had expenditures of \$148 million, which resulted in a \$2 million deficit in 2007. The total deficit at June 30, 2007 amounted to \$34 million. The fund's total assets decreased \$27 million or 47% compared with the prior year because of a decrease in cash in commercial banks, which was used to acquire capital assets.

The fund balance of The Children's Trust special revenue fund had a decrease of \$45 million. The decrease was mainly due to a reduction in revenues. Particular of fiscal year 2006, there were \$54 million transferred from GDB from investments related to QZAB bonds. No similar event occurred in the current year.

Although the revenue of other governmental funds (nonmajor) increased by \$2 million or 2% during the year compared with the prior year, the expenditures increased by \$226 million or 41%; the most significant increases in expenditures were noted in general government and intergovernmental activities of \$53 million and \$165 million, respectively. The fund had \$546 million in other financing sources. All of the foregoing led to a net decrease of \$109 million in the fund balance. Total assets of nonmajor funds decreased by \$349 million or 28% compared with the prior year.

#### ***Proprietary Funds***

The Commonwealth's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. As discussed in the business-type activities above, the Commonwealth's net assets decreased by \$20 million as a result of operations in the proprietary funds. This resulted from a

## **COMMONWEALTH OF PUERTO RICO**

### **Management's Discussion and Analysis (Unaudited)**

June 30, 2007

\$16.9 million increase in net assets by the lotteries fund, a decrease in net assets of \$84.4 million by the unemployment insurance fund, and an increase of net assets of \$47.4 million by the Commonwealth's other nonmajor enterprise funds.

#### **General Fund Budgetary Highlights**

Actual revenues of \$8,718 million were fairly consistent with final budgeted revenues (\$8,762 million). Nonetheless, actual revenues were \$347 million less than originally budgeted (\$9,065 million). The reduction is primarily attributable to (i) decrease in the gross national product, as reported by the Puerto Rico Planning Board, from 2.5% to 0.6%, (ii) the substitution of the sales and use tax for the 5% general excise tax, and (iii) certain income tax rate reductions included in the tax reform legislation approved on July 2006. The major categories of income affected with the abovementioned factors were the excise taxes with a decrease of \$195.8 million, income taxes with \$73.8 million, sales and use taxes with \$60.4 million and charges for services with \$44.8 million.

The actual expenditures reflected an increase of \$238 million when compared to the final budgeted amounts. The excess in expenditures was predominantly caused by the Department of Education of the Commonwealth with \$191 million, the Puerto Rico Health Insurance Administration with \$174 million and the Puerto Rico Medical Service Administration with \$50 million. These excess were partially neutralized by the savings achieved by the Executive Branch as part of the 10% budgetary reserve imposed to the agencies. Most of these variances were financed through the use of borrowings, approved by law or joint resolutions, from the Government Development Bank for Puerto Rico loans that provided resources of \$340 million.

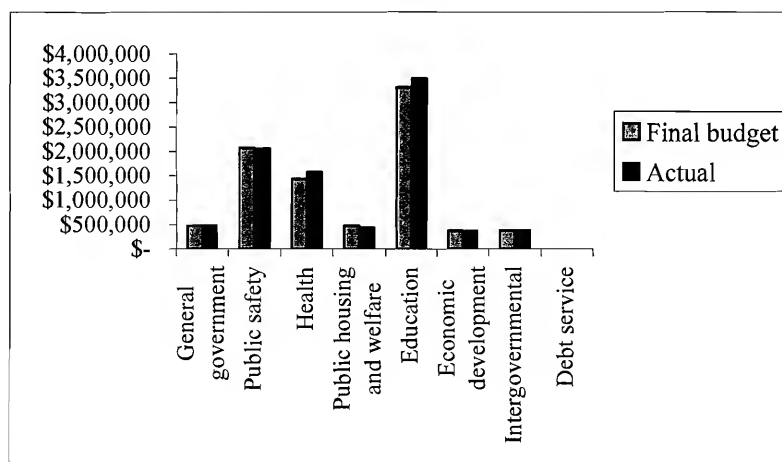
**COMMONWEALTH OF PUERTO RICO**  
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**Expenditures – General Fund**

**Budget vs. Actual**

Year ended June 30, 2007

(Expressed in thousands)



As of June 30, 2007, there was an excess of expenditures and other financing uses over revenue and other financing sources of \$505 million.

**Capital Assets and Debt Administration**

***Capital Assets***

The Commonwealth's investment in capital assets for its governmental and business-type activities as of June 30, 2007 amounts to \$10.1 billion, less accumulated depreciation of \$2.7 billion, leaving a book value of \$7.4 billion. This investment in capital assets includes land, buildings, building improvements, equipment, and construction in progress as infrastructure.

The net book value of capital assets at June 30, 2007 is distributed by function/activity in the following proportions: general government, 41%; public safety, 5%; health, 1%; public housing and welfare, 34%; education, 7%; and economic development, 12%. Actual capitalized assets were approximately \$842 million for the year. Depreciation charges for the year totaled \$236 million.

The infrastructure assets representing items that are normally immovable and of value only to the Commonwealth as roads, highways, bridges, toll facilities, water and sewer systems, lighting production, transmission and distribution systems, and similar items are principally owned by the component units of the Commonwealth. Therefore, the infrastructure assets are reported within depreciable capital assets under the discretely presented component units column. Additional information on the Commonwealth's capital assets can be found in note 12 to the basic financial statements that accompany this report.

## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis (Unaudited)

June 30, 2007

#### Commonwealth's Capital Assets – Primary Government

June 30, 2007

(Expressed in thousands)

	<b>Governmental activities</b>	<b>Business-type activities</b>
Land	\$ 844,533	—
Construction in progress	1,434,978	—
Buildings and building improvements, net	4,553,568	—
Equipment, furniture, fixtures and vehicles, net	226,050	674
Infrastructure, net	348,719	—
Total capital assets	<u>\$ 7,407,848</u>	<u>674</u>

#### ***Debt Administration***

General obligation bonds are backed by the full faith and credit of the Commonwealth, including the Commonwealth's power to levy additional taxes to help ensure repayment of the debt.

The Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit, and taxing power of the Commonwealth are not to be issued if the amount of the principal of, and interest on, such bonds and notes and on all such bonds and notes issued thereafter, which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual revenue raised under the provisions of Commonwealth legislation and conveyed into the treasury in the two fiscal years preceding the then current fiscal year. Section 2, Article VI of the Constitution of the Commonwealth does not limit the amount of debt that the Commonwealth may guarantee as long as the 15% limitation is not exceeded. At June 30, 2007, the Commonwealth is in compliance with the debt limitation requirement.

Moody's Investor Service lowered the rating on the Commonwealth's outstanding general obligation debt and appropriation debt from "Baa2" to "Baa3." Standard & Poor's Rating Services (S&P) had also lowered its rating on the Commonwealth's general obligation debt earlier in the year to BBB-, reflecting a long history of structural imbalance and the ongoing difficulties anticipated with further efforts to reduce the accrued deficit. The outlook was defined as stable.

The rating on the appropriation debt, typically rated one notch below the general obligation debt, has not been lowered, reflecting the improvements that have been made. S&P does not believe that Puerto Rico's appropriation credit is speculative grade.

S&P noted that Puerto Rico's debt, which is already high, is likely to increase. Although a major new revenue source of a 5.5% sales and use tax was added on November 16, 2006, balances remain difficult to achieve, requiring expense cuts and use of one-time revenue sources. Gap forecast suggests that balance will not be achieved until 2010, and that forecast is based on the expectation of flat expense growth.



**COMMONWEALTH OF PUERTO RICO**  
**Management's Discussion and Analysis (Unaudited)**

June 30, 2007

Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

The Commonwealth's total long-term obligations increased by \$1 billion during the current fiscal year, representing a 4% increase. Additional information on the Commonwealth's long-term obligations can be found in note 14 to the basic financial statements of this report.

**Economic Factors and Next Year's Budgets and Rates**

The average unemployment rate for the Commonwealth in 2007 was 10.4% down from the 2006 average rate of 11.7%. In terms of production, the real gross national product registered a decrease of 1.8%.

Based on the projections of the Puerto Rico Planning Board, the Puerto Rico economy is expected to reflect another decrease of 2.1% for the fiscal year 2008.

In an effort to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Executive Branch and the Legislature enacted and the Governor signed legislation providing for tax reform and fiscal reforms. The tax reform legislation is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based sales and use tax. The fiscal reform legislation is aimed at limiting expenditures in relation to past-spending rates and stabilizing expenditure growth at a level below that of recurring revenues.

On July 4, 2006, Act No. 117 (Act 117) was approved, which amends the Puerto Rico Internal Revenue Code of 1994 (the PR Code) to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the Central Government Sales Tax). Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5% (the Municipal Sales Tax and, together with the Central Government Sales Tax, the Sales Tax). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods) and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions, beginning during the tax year 2007, to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets. Act 117 repeals the 5.0% general excise tax imposed on imported goods and on goods manufactured in Puerto Rico. Certain items, such as fuel, crude oil and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items and will not be subject to the Sales Tax. The effective date of the repeal of the 5.0% general excise tax was October 17, 2006 pursuant to Act 229.

The Sales Tax became effective on November 15, 2006. Municipalities, however, were authorized to implement the Municipal Sales Tax starting on July 1, 2006. The revenues derived from the Sales Tax will be distributed as follows: (i) municipal governments will retain 1.5% of the Sales Tax, (ii) the Dedicated Sales Tax, created by Act No. 91 on May 13, 2006, as amended, will receive 1.0% of the Sales Tax, and (iii) the General Fund will receive 4.5% of the Sales Tax. The revenues to be generated by the Sales Tax will be partly offset by the partial elimination of the 5.0% general excise tax and the effect of the income tax reduction measures included in Act 117.

## **COMMONWEALTH OF PUERTO RICO**

### **Management's Discussion and Analysis (Unaudited)**

June 30, 2007

Act 117 also provided for special income tax rates with respect to certain transactions occurred on and between July 1, 2006 and December 31, 2006. These special tax rates will apply to eligible dividends declared by domestic corporations or partnerships and "built-in" gains associated with capital assets held for periods in excess of six months, as well as certain withdrawals from retirement accounts. These special tax rates are only available for transactions in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. In the case of resident corporations and partnerships, these special tax rates apply only to real property located in Puerto Rico.

The consolidated budget for the fiscal year 2006 – 07 amounts to \$26.5 billion. From this amount, \$20 billion is assigned to operating expenses, \$3 billion to a permanent capital improvements program, and \$3.5 billion for the debt service. For fiscal year 2007 – 08 the figures are: consolidated budget of \$26.9 billion, of which \$20.6 billion are assigned to operating expenses, \$2.9 billion to the capital improvements program, and \$3.5 billion to debt service.

#### **Requests for Information**

This financial report is designed to provide a general overview of the Commonwealth's finances for all of the Commonwealth's residents, taxpayers, customers, investors, and creditors. This financial report seeks to demonstrate the Commonwealth's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Department of the Treasury of the Commonwealth of Puerto Rico, Área de Contabilidad Central, P.O. Box 9024140, San Juan, PR 00902-4140.

**COMMONWEALTH OF PUERTO RICO**

Statement of Net Assets (Deficit)

June 30, 2007

(In thousands)

	Primary government			Component units
	Governmental activities	Business-type activities	Total primary government	
Assets:				
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ 83,625	161,104	244,729	3,135,274
Cash and cash equivalents in governmental banks	935,071	610,870	1,545,941	629,592
Investments, including collateral from securities lending transactions	163,900	—	163,900	2,474,213
Receivables, net of allowance for uncollectibles:				
Taxes	1,275,882	—	1,275,882	—
Unemployment and other insurance premiums	—	58,884	58,884	108,709
Intergovernmental	716,561	—	716,561	30,856
Accounts	132,276	—	132,276	894,660
Loans and advances	6,207	—	6,207	4,815,273
Accrued interest	22,298	3,059	25,357	512,001
Other	118,647	14,796	133,443	523,190
Due from:				
Primary government	—	—	—	392,685
Component units	149,545	8,847	158,392	483,605
Other governmental entities	394	—	394	294,645
Internal balances	8,271	(8,271)	—	—
Inventories	37,774	—	37,774	370,144
Prepaid expenses	7,749	—	7,749	49,137
Restricted assets:				
Cash and cash equivalents in commercial banks	720,425	—	720,425	867,106
Cash and cash equivalents in governmental banks	1,392,826	—	1,392,826	798,283
Investments and other restricted assets	33,605	35,606	69,211	7,039,100
Long-term investments	—	—	—	1,564,448
Long-term receivables from:				
Loans	—	—	—	122,831
Interest-bearing deposits with other banks	—	—	—	5,174
Other	—	—	—	481
Long-term amounts due from:				
Primary government	—	—	—	102,925
Component units	—	220,326	220,326	1,073,250
Other governmental entities	—	—	—	31,617
Real estate held for sale or future development	55,434	—	55,434	249,164
Deferred expenses and other assets	186,900	41,704	228,604	490,477
Capital assets (net of accumulated depreciation):				
Land and other nondepreciable assets	2,279,511	—	2,279,511	9,043,126
Depreciable assets	5,128,337	674	5,129,011	18,664,972
Total assets	\$ 13,455,238	1,147,599	14,602,837	54,766,938

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

Statement of Net Assets (Deficit)

June 30, 2007

(In thousands)

	<b>Primary government</b>			<b>Component units</b>
	<b>Governmental activities</b>	<b>Business- type activities</b>	<b>Total primary government</b>	
<b>Liabilities:</b>				
Accounts payable and accrued liabilities	\$ 1,986,379	7,162	1,993,541	2,494,432
Deposits and escrow liabilities	—	—	—	6,174,210
Tax refunds payable	312,041	—	312,041	—
Due to:				
Primary government	—	—	—	151,464
Component units	388,744	—	388,744	498,968
Other governmental entities	3,211	—	3,211	23,294
Securities lending transactions and reverse repurchase agreements	—	—	—	812,877
Interest payable	564,623	—	564,623	497,168
Deferred revenue	108,970	26,900	135,870	124,454
Tax revenue anticipation notes payable	881,484	—	881,484	—
Due to primary government – long-term portion	—	—	—	227,254
Due to component units – long-term portion	—	—	—	1,051,379
Deferred revenue long-term portion	—	—	—	21,537
Insurance benefits payable	—	57,915	57,915	—
Liability for automobile accident insurance and workmen's compensation claims	—	—	—	806,102
Liabilities payable within one year:				
Commonwealth appropriation bonds	99,971	—	99,971	21,017
Bonds	318,380	—	318,380	685,753
Notes	748,338	—	748,338	1,230,548
Capital leases	4,808	—	4,808	—
Compensated absences	1,065,805	3,945	1,069,750	253,190
Lottery awards	—	55,377	55,377	—
Other long-term liabilities	176,233	—	176,233	120,008
Liabilities payable after one year:				
Commonwealth appropriation bonds	2,463,421	—	2,463,421	1,367,292
Bonds	12,900,146	—	12,900,146	20,705,232
Notes	2,780,665	—	2,780,665	3,665,209
Capital leases	137,003	—	137,003	—
Net pension obligation	5,096,324	—	5,096,324	—
Compensated absences	728,310	2,052	730,362	334,895
Lottery awards	—	236,913	236,913	—
Other long-term liabilities	1,129,276	—	1,129,276	344,546
Total liabilities	<u>31,894,132</u>	<u>390,264</u>	<u>32,284,396</u>	<u>41,610,829</u>
<b>Net assets (deficit):</b>				
Invested in capital assets, net of related debt	3,635,271	674	3,635,945	10,556,494
Restricted for:				
Trust – nonexpendable	—	—	—	1,404,008
Capital projects	11,601	298,309	309,910	1,136,460
Debt service	159,817	—	159,817	703,010
Payment of unemployment and related benefits	—	612,170	612,170	—
Affordable housing and related loan insurance programs	159,633	—	159,633	692,349
Student loans and other educational purposes	—	—	—	15,415
Other	—	—	—	190,318
Unrestricted deficit	<u>(22,405,216)</u>	<u>(153,818)</u>	<u>(22,559,034)</u>	<u>(1,541,945)</u>
Total net assets (deficit)	<u>\$ (18,438,894)</u>	<u>757,335</u>	<u>(17,681,559)</u>	<u>13,156,109</u>

## COMMONWEALTH OF PUERTO RICO

Statement of Activities  
Year Ended June 30, 2007  
(In thousands)

Functions	Expenses	Program revenue			Net (expense) revenue and changes in net assets			
		Charges for services	Operating grants and contributions	Capital grants and contributions	Primary government			Component units
					Governmental activities	Business-type activities	Total	
Primary government:								
Governmental activities:								
Current:								
General government	\$ 2,847,596	503,922	69,248	—	(2,274,426)	—	(2,274,426)	—
Public safety	1,983,782	51,900	82,219	146	(1,849,517)	—	(1,849,517)	—
Health	1,943,582	123,449	736,399	2,351	(1,081,383)	—	(1,081,383)	—
Public housing and welfare	3,157,877	24,643	2,497,540	136,817	(498,877)	—	(498,877)	—
Education	4,748,008	2,747	1,375,326	100,907	(3,269,028)	—	(3,269,028)	—
Economic development	554,271	51,063	12,442	17,293	(473,473)	—	(473,473)	—
Intergovernmental	593,264	—	—	—	(593,264)	—	(593,264)	—
Interest and other	863,723	—	—	—	(863,723)	—	(863,723)	—
Total governmental activities	16,692,103	757,724	4,773,174	257,514	(10,903,691)	—	(10,903,691)	—
Business-type activities:								
Lotteries	679,274	869,221	—	—	—	189,947	189,947	—
Unemployment insurance	192,484	243,571	6,580	—	—	57,667	57,667	—
Other	26,860	27,747	36,900	—	—	37,787	37,787	—
Total business-type activities	898,618	1,140,539	43,480	—	—	285,401	285,401	—
Total primary government	\$ 17,590,721	1,898,263	4,816,654	257,514	(10,903,691)	285,401	(10,618,290)	—
Component units:								
Government Development Bank for Puerto Rico	\$ 798,285	773,804	—	124,358	—	—	—	99,877
Puerto Rico Highways and Transportation Authority	929,314	280,435	—	126,718	—	—	—	(522,161)
Puerto Rico Electric Power Authority	3,798,245	3,680,390	—	—	—	—	—	(117,855)
Puerto Rico Aqueduct and Sewer Authority	821,742	755,538	23,162	—	—	—	—	(43,042)
Puerto Rico Infrastructure Financing Authority	146,168	—	—	—	—	—	—	(146,168)
Puerto Rico Health Insurance Administration	1,594,330	501,090	—	—	—	—	—	(1,093,240)
University of Puerto Rico	1,331,332	159,724	140,422	—	—	—	—	(1,031,186)
Puerto Rico Sales Tax Financing Corporation	240,238	—	—	—	—	—	—	(240,238)
Other component units	2,621,106	1,790,211	37,748	20,393	—	—	—	(772,754)
Total component units	\$ 12,280,760	7,941,192	201,332	271,469	—	—	—	(3,866,767)
General revenue:								
Taxes:								
Income taxes					\$ 6,488,211	—	6,488,211	—
Excise taxes					1,475,311	—	1,475,311	309,778
Sales and use tax					583,639	—	583,639	126,712
Other taxes					4,663	—	4,663	51,929
Revenue from global tobacco settlement agreement					69,604	—	69,604	—
Revenue from Puerto Rico Tourism Company					23,128	—	23,128	—
Revenue from Governing Board of 9-1-1 Services					9,191	—	9,191	—
Revenue from Puerto Rico Sales Tax Financing Corporation					240,238	—	240,238	—
Revenue from State Insurance Fund Corporation					39,175	—	39,175	—
Grants and contributions not restricted to specific programs					135,916	—	135,916	176,160
Payments from primary government					—	—	—	2,614,065
Unrestricted investment earnings					176,674	37,177	213,851	518,023
Gain on sale of assets					—	—	—	25,669
Other					71,187	—	71,187	56,350
Transfers					342,743	(342,743)	—	—
Total general revenue and transfers					9,659,680	(305,566)	9,354,114	3,878,686
Change in net assets					(1,244,011)	(20,165)	(1,264,176)	11,919
Net assets (deficit)– beginning of year (as restated)					(17,194,883)	777,500	(16,417,383)	13,144,190
Net assets (deficit) – end of year					\$ (18,438,894)	757,335	(17,681,559)	13,156,109

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

**Balance Sheet – Governmental Funds**

June 30, 2007

(In thousands)

<b>Assets</b>	<b>General</b>	<b>Debt service</b>	<b>PBA capital projects</b>	<b>The Children's Trust special revenue</b>	<b>Other governmental</b>	<b>Totals governmental</b>
Cash and cash equivalents in commercial banks	\$ 39,481	—	—	—	44,144	83,625
Cash and cash equivalents in governmental banks	110,866	423,190	—	72,911	328,104	935,071
Investments	—	—	—	49,038	114,862	163,900
Receivables, net of allowance for uncollectibles:						
Taxes	1,275,882	—	—	—	—	1,275,882
Intergovernmental	704,776	11,785	—	—	—	716,561
Accounts	121,667	—	—	—	10,609	132,276
Loans	6,171	—	—	—	36	6,207
Accrued interest	20,205	1,327	—	317	449	22,298
Other	278	—	—	—	—	278
Due from:						
Other funds	61,446	—	—	—	178,011	239,457
Component units	105,471	—	—	—	44,074	149,545
Other governmental entities	—	—	—	—	394	394
Restricted assets:						
Cash and cash equivalents in commercial banks	540,571	—	29,754	—	150,100	720,425
Cash and cash equivalents in governmental banks	1,392,826	—	—	—	—	1,392,826
Other assets	33,605	—	—	—	—	33,605
Real estate held for sale or future development	39,196	—	—	—	16,238	55,434
<b>Total assets</b>	<b>\$ 4,452,441</b>	<b>436,302</b>	<b>29,754</b>	<b>122,266</b>	<b>887,021</b>	<b>5,927,784</b>

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

Balance Sheet – Governmental Funds

June 30, 2007

(In thousands)

<b>Liabilities and fund balances</b>	<b>General</b>	<b>Debt service</b>	<b>PBA capital projects</b>	<b>The Children's Trust special revenue</b>	<b>Other governmental</b>	<b>Totals governmental</b>
<b>Liabilities:</b>						
Accounts payable and accrued liabilities	\$ 1,870,992	5,689	63,976	932	76,684	2,018,273
Tax refunds payable	312,041	—	—	—	—	312,041
Due to:						
Other funds	231,186	—	—	—	—	231,186
Other governmental entities	3,211	—	—	—	—	3,211
Component units	368,370	—	—	—	20,374	388,744
Notes payable	169,963	—	—	—	129,112	299,075
Bonds payable	—	208,460	—	—	75,690	284,150
Interest payable	55,395	194,118	—	—	82,041	331,554
Deferred revenues	1,070,957	—	—	—	—	1,070,957
Tax revenue anticipation notes payable	881,484	—	—	—	—	881,484
<b>Total liabilities</b>	<b>4,963,599</b>	<b>408,267</b>	<b>63,976</b>	<b>932</b>	<b>383,901</b>	<b>5,820,675</b>
<b>Fund balances (deficit):</b>						
Reserved for:						
Encumbrances	744,950	—	—	—	97,721	842,671
Debt service	—	28,035	—	—	—	28,035
Capital projects	13,797	—	—	—	—	13,797
Assets in liquidation	74,940	—	—	—	—	74,940
Low income housing assistance	159,633	—	—	—	—	159,633
Unreserved (deficit):						
General fund	(1,504,478)	—	—	—	—	(1,504,478)
Debt service funds	—	—	—	—	131,782	131,782
Special revenue funds	—	—	—	121,334	15,952	137,286
Capital projects funds	—	—	(34,222)	—	257,665	223,443
<b>Total fund balances (deficit)</b>	<b>(511,158)</b>	<b>28,035</b>	<b>(34,222)</b>	<b>121,334</b>	<b>503,120</b>	<b>107,109</b>
<b>Total liabilities and fund balances (deficit)</b>	<b>\$ 4,452,441</b>	<b>436,302</b>	<b>29,754</b>	<b>122,266</b>	<b>887,021</b>	<b>5,927,784</b>

## COMMONWEALTH OF PUERTO RICO

### Reconciliation of the Balance Sheet to the Statement of Net Assets – Governmental Funds

Year ended June 30, 2007

(In thousands)

Amounts reported for governmental activities in the statement of net assets  
are different because:

Total fund balances of governmental funds	\$ 107,109
Inventories and prepaid expenses that are not available to pay for current period expenditures and therefore are not recognized in the funds	45,523
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	7,407,848
Long-term account receivable from global tobacco settlement agreement and PBA	118,369
Deferred revenue in governmental funds that are recognized as revenue in the governmental activities	961,987
Debt issued by the Commonwealth have associated costs that are paid from current available resources in the funds. However, these costs are deferred on the statement of net assets	182,536
Net pension asset of the Puerto Rico Judiciary Retirement System recognized in governmental activities is not a financial resource and, therefore, is not reported in the funds	4,364
Liabilities, including appropriation bonds (\$2,563,392), bonds payable (\$12,934,376), notes payable (\$3,229,928), capital leases payable, (\$141,811), compensated absences (\$1,769,803), net pension obligation (\$5,096,324), and other long-term liabilities (\$1,297,927) are not due and payable in the current period and therefore are not reported in the funds	(27,033,561)
Interest liabilities are not due and payable in the current period and, therefore, are not reported in the funds	(233,069)
Deficit of governmental activities	\$ <u>(18,438,894)</u>

See accompanying notes to basic financial statements.



**COMMONWEALTH OF PUERTO RICO**  
Statement of Revenue, Expenditures, and Changes in Fund Balances –  
Governmental Funds  
Year ended June 30, 2007  
(In thousands)

	General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
<b>Revenue:</b>						
Taxes:						
Income taxes	\$ 6,389,973	—	—	—	—	6,389,973
Excise taxes	1,475,311	—	—	—	—	1,475,311
Sales and use tax	583,639	—	—	—	—	583,639
Other taxes	4,663	—	—	—	—	4,663
Charges for services	757,724	—	—	—	—	757,724
Revenue from global tobacco settlement agreement	—	—	—	—	68,665	68,665
Revenues from component units:						
Governing Board of 9-1-1 Services	9,191	—	—	—	—	9,191
Tourism Company of Puerto Rico	23,128	—	—	—	—	23,128
Puerto Rico Sales Tax Financing Corporation	223,282	—	—	—	16,956	240,238
State Insurance Fund Corporation	39,175	—	—	—	—	39,175
Intergovernmental	5,029,854	120,441	—	—	16,309	5,166,604
Interest and investment earnings	148,638	8,518	—	7,376	12,142	176,674
Other	39,725	8,638	—	—	5,264	53,627
<b>Total revenue</b>	<b>14,724,303</b>	<b>137,597</b>	<b>—</b>	<b>7,376</b>	<b>119,336</b>	<b>14,988,612</b>
<b>Expenditures:</b>						
Current:						
General government	2,313,735	—	—	—	224,264	2,537,999
Public safety	1,863,148	—	—	—	1,108	1,864,256
Health	1,940,520	—	—	622	7,059	1,948,201
Public housing and welfare	3,046,812	—	—	—	1,773	3,048,585
Education	4,356,304	—	—	20,514	23,503	4,400,321
Economic development	512,966	—	—	1,381	18,906	533,253
Intergovernmental	426,352	—	—	—	166,895	593,247
Capital outlays	308,370	—	148,009	—	56,445	512,824
Debt service:						
Principal	608,410	208,474	—	—	87,720	904,604
Interest and other	219,419	408,980	—	253	174,990	803,642
Debt issuance costs	—	2,751	—	—	8,330	11,081
<b>Total expenditures</b>	<b>15,596,036</b>	<b>620,205</b>	<b>148,009</b>	<b>22,770</b>	<b>770,993</b>	<b>17,158,013</b>
<b>Excess of expenditures over revenue</b>	<b>(871,733)</b>	<b>(482,608)</b>	<b>(148,009)</b>	<b>(15,394)</b>	<b>(651,657)</b>	<b>(2,169,401)</b>
<b>Other financing sources (uses):</b>						
Transfers in	774,480	82,386	145,813	243	162,153	1,165,075
Transfers out	(414,916)	—	—	(71,627)	(335,789)	(822,332)
Long-term debt issued	381,791	—	—	42,000	716,565	1,140,356
Capital leases	2,975	—	—	—	—	2,975
Refunding bonds issued	—	379,498	—	—	—	379,498
<b>Total other financing sources (uses)</b>	<b>744,330</b>	<b>461,884</b>	<b>145,813</b>	<b>(29,384)</b>	<b>542,929</b>	<b>1,865,572</b>
<b>Net change in fund balances (deficit)</b>	<b>(127,403)</b>	<b>(20,724)</b>	<b>(2,196)</b>	<b>(44,778)</b>	<b>(108,728)</b>	<b>(303,829)</b>
<b>Fund balances (deficit) at beginning of year</b>	<b>(383,755)</b>	<b>48,759</b>	<b>(32,026)</b>	<b>166,112</b>	<b>611,848</b>	<b>410,938</b>
<b>Fund balances (deficit) at end of year</b>	<b>\$ (511,158)</b>	<b>28,035</b>	<b>(34,222)</b>	<b>121,334</b>	<b>503,120</b>	<b>107,109</b>

See accompanying notes to basic financial statements.

# COMMONWEALTH OF PUERTO RICO

## Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances to the Statement of Activities – Governmental Funds

Year ended June 30, 2007

(In thousands)

Amounts reported for governmental activities in the statement of activities are different because:

Net change in fund balances – total governmental funds	\$ (303,829)
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays (\$517,572) exceeded depreciation (\$235,691) in the current period.	281,881
Impairment of capital assets are expensed in the statement of activities but not reported in the governmental funds as such impairment does not require the use of current financial resources.	(3,421)
Revenue in the statement of activities that do not provide current financial resources are not reported as revenue in the governmental funds.	18,499
Debt proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount by which net proceeds (\$1,522,750) exceeded repayments (\$904,604).	(618,146)
Income tax revenue that are not currently available are deferred in the governmental funds, but are accruable as revenue in the statement of activities. This is the amount by which deferred revenue increased during the year.	98,239
Governmental funds do not report transfers of long-term assets or liabilities because such transfers do not represent financial resources; however, they are recorded in the statement of activities. This amount represents the transfer of property by the Commonwealth to certain municipalities (note 12).	(28,659)
Generally, inventory and prepayments are recorded as expenditures in the governmental funds when purchased rather than capitalized as an asset. However, these assets are capitalized in the statement of net assets. This is the sum of the increase in inventory (\$14,764) and net pension asset (\$2,921) for the year.	11,843
Debt issuance costs are expenditures to governmental funds, but are deferred assets in the statement of net assets. This is the amount of debt issue costs for the year.	11,081
Certain interest and other costs reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This is the amount equivalent to the increase in interest payable (\$60,234), combined with the amortization of debt issue costs (\$11,220), and the net accretion and amortization of debt issue discount and deferred losses (\$34,996).	(106,450)
Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds. This is the amount by which the net increases in net pension obligation (\$351,154), accrued compensated absences (\$110,162), and liability for claims and judgments (\$149,109) exceeded the net decreases in Christmas bonus liability (\$2,488) and liability in federal cost disallowances (\$2,888).	(605,049)
Change in deficit of governmental activities	\$ <u>(1,244,011)</u>

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

Statement of Revenue and Expenditures – Budget and Actual –  
Budget Basis – General Fund

Year ended June 30, 2007

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Revenue:				
Income taxes	\$ 6,261,000	6,238,000	6,187,115	(50,885)
Excise taxes	1,673,000	1,489,000	1,477,178	(11,822)
Other taxes	109,000	101,000	103,073	2,073
Sales and use taxes	643,000	576,000	582,560	6,560
Charge for services	245,000	214,000	200,200	(13,800)
Intergovernmental	14,000	15,000	14,504	(496)
Revenue from component units	24,000	24,000	23,128	(872)
Other	96,000	105,000	129,864	24,864
Total revenue	<u>9,065,000</u>	<u>8,762,000</u>	<u>8,717,622</u>	<u>(44,378)</u>
Expenditures:				
Current:				
General government	476,391	480,976	471,385	9,591
Public safety	2,059,411	2,077,070	2,053,900	23,170
Health	1,428,648	1,432,705	1,580,444	(147,739)
Public housing and welfare	478,586	479,342	439,626	39,716
Education	3,311,426	3,313,911	3,494,585	(180,674)
Economic development	374,245	380,324	363,512	16,812
Intergovernmental	382,608	382,859	382,054	805
Total expenditures	<u>8,511,315</u>	<u>8,547,187</u>	<u>8,785,506</u>	<u>(238,319)</u>
Excess (deficiency) of revenue over (under) expenditures	<u>553,685</u>	<u>214,813</u>	<u>(67,884)</u>	<u>(282,697)</u>
Other financing sources (uses):				
Notes payable issued	—	—	339,564	339,564
Transfer in	98,000	121,000	144,829	23,829
Transfer out	<u>(976,686)</u>	<u>(940,813)</u>	<u>(921,373)</u>	<u>19,440</u>
Total other financing sources (uses)	<u>(878,686)</u>	<u>(819,813)</u>	<u>(436,980)</u>	<u>382,833</u>
Excess of expenditures and other financing uses over revenue and other financing sources	<u>\$ (325,001)</u>	<u>(605,000)</u>	<u>(504,864)</u>	<u>100,136</u>

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

Statement of Net Assets – Proprietary Funds

June 30, 2007

(In thousands)

<b>Assets</b>	<b>Unemployment insurance</b>	<b>Lotteries</b>	<b>Other proprietary</b>	<b>Total</b>
Current assets:				
Cash and cash equivalents in commercial banks	\$ —	57,897	103,207	161,104
Cash and cash equivalents in governmental banks	461,945	68,866	80,059	610,870
Receivable, net:				
Insurance premiums, net	54,284	—	4,600	58,884
Component units	—	—	8,847	8,847
Accrued interest	569	—	2,490	3,059
Other	8,929	5,443	424	14,796
Total current assets	525,727	132,206	199,627	857,560
Noncurrent assets:				
Loans receivable from component units, excluding current portion, net	—	—	220,326	220,326
Due from other funds	—	53,175	—	53,175
Restricted investments	—	—	35,606	35,606
Capital assets, net	—	674	—	674
Other	—	39,994	1,710	41,704
Total assets	\$ 525,727	226,049	457,269	1,209,045
<b>Liabilities and Net Assets (Deficit)</b>				
Current liabilities:				
Accounts payable and accrued liabilities	\$ —	4,675	2,487	7,162
Due to other funds	—	61,446	—	61,446
Deferred revenue	10,156	16,716	28	26,900
Compensated absences	—	2,346	1,599	3,945
Lottery awards	—	55,377	—	55,377
Insurance benefits payable	56,781	—	1,134	57,915
Total current liabilities	66,937	140,560	5,248	212,745
Noncurrent liabilities:				
Compensated absences	—	1,720	332	2,052
Lottery awards	—	236,913	—	236,913
Total liabilities	\$ 66,937	379,193	5,580	451,710
Net assets (deficit):				
Invested in capital assets	\$ —	674	—	674
Restricted for:				
Payment of insurance benefits	458,790	—	153,380	612,170
Capital projects	—	—	298,309	298,309
Unrestricted	—	(153,818)	—	(153,818)
Total net assets (deficit)	\$ 458,790	(153,144)	451,689	757,335

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**  
Statement of Revenue, Expenses and Changes in Net Assets –  
Proprietary Funds  
Year ended June 30, 2007  
(In thousands)

	Unemployment insurance	Lotteries	Other proprietary funds	Total
Operating revenues:				
Lottery ticket sales	\$ —	869,168	—	869,168
Insurance premiums	243,571	—	20,313	263,884
Interest	—	—	7,434	7,434
Other	—	53	—	53
Total operating revenues	243,571	869,221	27,747	1,140,539
Operating expenses:				
Lottery awards	—	544,138	—	544,138
Insurance benefits	192,484	—	4,510	196,994
General, administrative, and other operating expenses	—	134,802	22,350	157,152
Depreciation and amortization	—	334	—	334
Total operating expenses	192,484	679,274	26,860	898,618
Operating income	51,087	189,947	887	241,921
Nonoperating revenue:				
Contributions from federal government	6,580	—	36,900	43,480
Interest and investment earnings	27,872	7,097	2,208	37,177
Total nonoperating revenue	34,452	7,097	39,108	80,657
Income before transfers	85,539	197,044	39,995	322,578
Transfers from general fund	—	16,863	7,458	24,321
Transfers to general fund	(169,933)	(197,044)	(87)	(367,064)
Net change in net assets (deficit)	(84,394)	16,863	47,366	(20,165)
Net assets (deficit) at beginning of year	543,184	(170,007)	404,323	777,500
Net assets (deficit) at end of year	\$ 458,790	(153,144)	451,689	757,335

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

Statement of Cash Flows –  
Proprietary Funds

Year ended June 30, 2007

(In thousands)

	<b>Unemployment insurance</b>	<b>Lotteries</b>	<b>Other proprietary</b>	<b>Total</b>
Cash flows from operating activities:				
Receipts from customers and users	\$ 244,304	868,280	23,855	1,136,439
Other receipts	—	53	15,429	15,482
Payments to suppliers and employees	—	(138,084)	(22,217)	(160,301)
Payment of lottery prizes	—	(555,550)	—	(555,550)
Payments of insurance benefits	(205,537)	—	(4,623)	(210,160)
Other payments	—	—	(50,874)	(50,874)
Net cash provided by (used in) operating activities	<u>38,767</u>	<u>174,699</u>	<u>(38,430)</u>	<u>175,036</u>
Cash flows from noncapital financing activities:				
Intergovernmental grants and contributions	6,580	—	36,900	43,480
Transfers from general fund	—	—	7,458	7,458
Transfers to other funds	(146,923)	(176,242)	(87)	(323,252)
Net cash provided by (used in) noncapital financing activities	<u>(140,343)</u>	<u>(176,242)</u>	<u>44,271</u>	<u>(272,314)</u>
Cash flows from investing activities:				
Interest received on deposits and investments	27,870	7,097	2,178	37,145
Purchases of investments	—	—	(2,133)	(2,133)
Net cash provided by (used in) investing activities	<u>27,870</u>	<u>7,097</u>	<u>45</u>	<u>35,012</u>
Net increase (decrease) in cash and cash equivalents	<u>(73,706)</u>	<u>5,554</u>	<u>5,886</u>	<u>(62,266)</u>
Cash and equivalents at beginning of year	<u>535,651</u>	<u>121,209</u>	<u>177,380</u>	<u>834,240</u>
Cash and cash equivalents at end of year	<u>\$ 461,945</u>	<u>126,763</u>	<u>183,266</u>	<u>771,974</u>
Reconciliation of operating income to net cash provided by (used in) operating activities:				
Operating income	\$ 51,086	189,947	887	241,920
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Depreciation and amortization	—	334	—	334
Interests earned on deposits loans and investments	—	—	(173)	(173)
Changes in operating assets and liabilities:				
Decrease (increase) in accounts and loans receivable	2,322	(888)	(37,468)	(36,034)
Decrease in other assets	—	378	11	389
Decrease in obligation for unpaid lottery awards	—	(11,412)	—	(11,412)
Decrease in due to other funds	—	(2,269)	—	(2,269)
Increase (decrease) in deferred revenues	(1,589)	(2,299)	2	(3,886)
Increase (decrease) in compensated absences	—	(251)	(1,186)	(1,437)
Increase (decrease) in liability for insurance benefits payable	(13,052)	—	(113)	(13,165)
Increase (decrease) in accounts payable and accrued liabilities	—	1,159	(390)	769
Total adjustments	<u>(12,319)</u>	<u>(15,248)</u>	<u>(39,317)</u>	<u>(66,884)</u>
Net cash provided by (used in) operating activities	<u>\$ 38,767</u>	<u>174,699</u>	<u>(38,430)</u>	<u>175,036</u>

See accompanying notes to basic financial statements.

# COMMONWEALTH OF PUERTO RICO

## Statement of Fiduciary Net Assets

June 30, 2007

(In thousands)

<b>Assets</b>	<b>Pension trust</b>	<b>Special deposits – agency</b>
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ 77,642	653,310
Cash and cash equivalents in governmental banks:		
Unrestricted	269,953	189,454
Restricted	2,310	—
Investments:		
Debt and equity securities, at fair value	4,618,650	—
Other	94,470	15,606
Receivables, net:		
Accounts	119,890	—
Loans and advances	941,691	—
Accrued interest and dividends	9,668	—
Due from general fund	4,615	—
Other	31,639	—
Capital assets, net	34,366	—
Other assets	8,071	—
<b>Total assets</b>	<b>6,212,965</b>	<b>858,370</b>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	75,701	858,370
Other liabilities	1,570	—
<b>Total liabilities</b>	<b>77,271</b>	<b>858,370</b>
<b>Net Assets</b>		
Net assets held in trust for pension and other benefits	\$ <u>6,135,694</u>	<u>—</u>

See accompanying notes to basic financial statements.

# COMMONWEALTH OF PUERTO RICO

## Statement of Changes in Fiduciary Net Assets – Pension Trust Funds

Year ended June 30, 2007

(In thousands)

Additions:		
Contributions:		
Sponsor	\$	497,346
Participants		469,428
Special		156,453
Total contributions		<u>1,123,227</u>
Interest and investment income:		
Interest		135,045
Dividends		28,372
Net change in fair value of investments		782,754
Investment expenses		<u>(19,349)</u>
Net interest and investment income		<u>926,822</u>
Other income		<u>21,171</u>
Total additions		<u>2,071,220</u>
Deductions:		
Pension and other benefits		1,255,681
Refunds of contributions		38,790
General and administrative		<u>62,123</u>
Total deductions		<u>1,356,594</u>
Net change in net assets held in trust for pension and other benefits		714,626
Net assets held in trust for pension and other benefits:		
Beginning of year		<u>5,421,068</u>
End of year	\$	<u><u>6,135,694</u></u>

See accompanying notes to basic financial statements.



**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Net Assets –  
Major Component Units

June 30, 2007

(In thousands)

Assets	Government Development Bank for Puerto Rico	Major Component Units							Total nonmajor component units	Total component units
		Puerto Rico Aqueduct and Sewer Authority	Puerto Rico Electric Power Authority	Puerto Rico Health Insurance Administration	Puerto Rico Highways and Transportation Authority	Puerto Rico Infrastructure Financing Authority	Puerto Rico Sales Tax Financing Corporation	Puerto Rico University of Puerto Rico		
<b>Assets:</b>										
Current assets:										
Cash and cash equivalents in commercial banks	\$ 2,821,798	45,420	40,441	49,821	37,299	—	—	9,108	131,387	3,135,274
Cash and cash equivalents in governmental banks	—	514	—	—	30,270	41,076	—	42,534	515,198	629,592
Investments, including collateral from securities lending transactions	794,926	—	—	—	—	—	—	—	1,679,287	2,474,213
Receivables, net:										
Insurance premium	—	—	—	—	—	—	—	—	108,709	108,709
Intergovernmental	—	6,104	—	—	—	—	—	22,330	2,422	30,856
Accounts	—	115,562	543,225	—	9,414	—	16,737	14,367	195,355	894,660
Loans and advances	4,755,973	—	—	—	—	—	—	—	59,300	4,815,273
Accrued interest	469,702	—	6,481	194	—	1,818	319	—	33,487	512,001
Other	—	74,043	128,046	20,610	—	11,569	—	—	60,377	294,645
Due from:										
Primary government	—	—	145,218	148,900	—	—	—	23,355	75,212	392,685
Component units	411,374	16,912	31,909	—	—	—	—	19,337	20,985	483,605
Inventories	—	742	308,739	—	—	—	—	6,438	38,055	370,144
Prepaid expenses	—	—	6,177	189	2,881	808	—	23,527	14,813	49,137
<b>Total current assets</b>	<b>9,253,773</b>	<b>259,297</b>	<b>1,319,497</b>	<b>231,173</b>	<b>79,864</b>	<b>89,497</b>	<b>17,056</b>	<b>234,210</b>	<b>3,229,617</b>	<b>14,713,984</b>
Noncurrent assets:										
Restricted assets:										
Cash and cash equivalents in commercial banks	82,755	124,341	427,236	—	2,355	87,695	—	11,455	131,269	867,106
Cash and cash equivalents in governmental banks	—	33,166	—	—	37,922	20,171	—	3,525	592,721	798,283
Investments and other restricted assets	1,381,798	—	581,977	—	823,001	1,956,429	—	360,261	1,935,634	7,039,100
Receivables:										
Loans, interest, and other	—	—	—	—	—	—	—	—	1,564,448	1,564,448
Interest-bearing deposits with other banks	—	—	—	—	—	—	—	2,975	119,856	122,831
Other governmental entities	—	—	—	—	—	—	—	—	5,174	5,174
Other	—	—	—	—	—	—	—	—	31,617	31,617
Due from:										
Primary government	—	—	30,427	—	—	—	—	72,498	—	102,925
Component units	1,064,208	—	—	—	—	—	—	—	9,042	1,073,250
Real estate held for sale and future development	66,688	—	—	—	—	—	—	—	182,476	249,164
Capital assets, not being depreciated	10,971	1,039,907	2,348,484	—	2,997,138	1,228,334	—	140,147	1,278,145	9,043,126
Capital assets, depreciable, net	13,554	4,207,861	3,406,084	571	8,242,044	173	—	660,198	2,134,487	18,664,972
Deferred expenses and other assets	53,337	29,136	127,985	—	160,371	60,923	—	—	58,725	490,477
<b>Total noncurrent assets</b>	<b>2,673,311</b>	<b>5,434,411</b>	<b>6,922,193</b>	<b>571</b>	<b>12,262,831</b>	<b>3,353,725</b>	<b>110,778</b>	<b>1,251,059</b>	<b>8,044,075</b>	<b>40,052,954</b>
<b>Total assets</b>	<b>\$ 11,927,084</b>	<b>\$ 6,693,708</b>	<b>\$ 8,241,690</b>	<b>\$ 231,744</b>	<b>\$ 12,342,695</b>	<b>\$ 3,443,222</b>	<b>\$ 127,834</b>	<b>\$ 1,485,269</b>	<b>\$ 11,273,692</b>	<b>\$ 54,766,938</b>

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Net Assets –  
Major Component Units

June 30, 2007

(In thousands)

	Government Development Bank for Puerto Rico	Major Component Units							Total nonmajor component units	Total component units
		Puerto Rico Aqueduct and Sewer Authority	Puerto Rico Electric Power Authority	Puerto Rico Health Insurance Administration	Puerto Rico Highways and Transportation Authority	Puerto Rico Infrastructure Financing Authority	Puerto Rico Sales Tax Financing Corporation	University of Puerto Rico		
<b>Liabilities:</b>										
Current liabilities:										
Accounts payable and accrued liabilities	\$ 103,361	301,139	653,162	146,948	141,560	89,771	—	115,454	943,037	2,494,432
Deposits and escrow liabilities	5,469,794	5,429	159,104	—	—	—	—	—	539,883	6,174,210
Due to:										
Primary government	—	9,027	—	27,600	—	—	—	—	114,837	151,464
Component units	—	76,054	41,732	—	—	1,364	—	15,368	364,450	498,968
Other governmental entities	—	—	—	—	—	—	—	41	23,253	23,294
Securities lending transactions and reverse repurchase agreements	455,000	—	—	—	—	—	—	—	357,877	812,877
Interest payable	48,311	10,591	102,935	—	139,136	63,249	—	5,833	127,113	497,168
Deferred revenue	—	21,901	387,277	—	—	77	—	36	102,440	124,454
Notes payable, current portion	692,846	—	—	—	—	—	—	—	130,425	1,230,548
Commonwealth appropriation bonds, current portion	39	18,409	—	—	—	40	—	—	2,529	21,017
Bonds payable, current portion	70,698	19,989	361,694	—	66,020	32,225	—	22,790	113,882	687,298
Compensated absences	5,015	12,386	95,882	453	15,985	128	—	24,920	98,421	253,190
Workers compensation claims	—	—	—	—	—	—	—	—	687,829	687,829
Liability for automobile accident benefit payments	—	—	—	—	—	—	—	—	118,273	118,273
Current portion of other long-term liabilities	—	—	78,226	—	3,393	—	—	1,100	37,289	120,008
Total current liabilities	6,845,064	474,925	1,880,012	175,001	366,094	186,854	—	185,542	3,781,538	13,895,030
Noncurrent liabilities:										
Due to:										
Primary government	—	220,146	—	—	—	—	—	—	7108	227,254
Component units	—	63,470	7,757	—	—	51,926	303,024	21,903	603,299	1,051,379
Deferred revenue	—	—	—	—	—	—	—	—	21,537	21,537
Notes payable	1,587,067	250,000	467,784	—	—	10,467	—	—	1,360,358	3,665,209
Commonwealth appropriation bonds	10,160	1,052,759	—	—	—	3,065,378	—	—	293,906	1,367,292
Bonds payable	1,212,556	1,276,664	5,286,015	—	6,939,230	3,065,378	—	715,062	2,208,782	20,703,687
Compensated absences	997	54,165	128,714	302	10,691	222	—	119,608	20,196	334,895
Other long-term liabilities	—	63,595	—	—	31,940	6,000	—	79,727	163,284	344,546
Total noncurrent liabilities	2,810,780	2,980,799	5,890,270	302	6,981,861	3,133,993	303,024	936,300	4,678,470	27,715,799
Total liabilities	9,655,844	3,455,724	7,770,282	175,303	7,347,955	3,320,847	303,024	1,121,842	8,460,008	41,610,829
<b>Net assets:</b>										
Invested in capital assets, net of related debt	24,525	2,987,685	168,307	571	4,281,724	1,228,507	—	231,026	1,634,149	10,556,494
Restricted for:										
Trust – nonexpendable	—	—	—	—	—	—	—	62,406	—	1,404,008
Capital projects	—	—	315,154	—	71,674	624,911	—	24,791	99,930	1,136,460
Debt service	25,504	—	—	—	630,893	14,362	(175,190)	56,234	151,207	703,010
Affordable housing and related loan insurance programs	274,422	—	—	—	—	—	—	—	417,927	692,349
Student loans and other educational purposes	—	—	—	—	—	—	—	7,686	7,729	15,415
Other specified purposes	—	19,284	—	—	—	—	—	32,136	120,012	190,318
Unrestricted (deficit)	1,946,789	(768,985)	(12,053)	55,870	10,449	(3,105,893)	—	(50,852)	382,730	(1,541,945)
Total net assets (deficit)	2,271,240	2,237,984	471,408	56,441	4,994,740	122,375	(175,190)	363,427	2,813,684	13,156,109
Total liabilities and net assets (deficit)	\$ 11,927,084	5,693,708	8,241,690	231,744	12,342,695	3,443,222	127,834	1,485,269	11,273,692	54,766,938

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Activities –  
Major Component Units

Year ended June 30, 2007

(in thousands)

	Expenses	Program revenues		Net revenues (expenses) and changes in net assets	General revenues					Change in net assets	Net assets, beginning of year	Net assets, end of year
		Charges for services	Operating grants and contributions	Capital grants and contributions	Payments from primary government	Payments from (to) component units	Contributions not restricted to specific programs	Taxes	Interest and investment earnings	Gain on sale of assets		
Major component units:												
Government Development Bank for Puerto Rico	\$ 798,285	773,804	—	124,558	65,850	608	—	—	—	—	2,096,436	2,271,240
Puerto Rico Aqueduct and Sewer Authority	821,742	755,538	23,162	—	700	43,648	—	—	7,650	—	2,223,816	2,237,984
Puerto Rico Electric Power Authority	3,798,245	3,680,390	—	—	—	—	57,137	—	20,942	—	511,184	471,408
Puerto Rico Health Insurance Administration	1,594,330	501,090	—	—	1,142,347	—	—	—	4,129	—	3,205	56,441
Puerto Rico Highways and Transportation Authority	929,314	280,435	—	126,718	—	—	—	302,871	29,185	—	5,184,845	4,994,740
Puerto Rico Infrastructure Financing Authority	146,168	—	—	—	98,320	125	—	—	93,737	—	76,361	122,375
Puerto Rico Sales Tax Financing Corporation	240,238	—	—	—	—	(62,786)	—	126,712	1,122	—	(175,190)	(175,190)
University of Puerto Rico	1,331,332	159,724	140,422	—	861,503	70,338	115,955	—	9,116	—	330,215	363,427
Nonmajor component units	2,621,106	1,790,211	37,748	20,393	445,345	(51,933)	3,068	58,836	352,142	25,669	2,718,128	2,813,684
	\$ 12,280,760	7,941,192	201,332	271,469	2,614,065	—	176,160	488,419	518,023	25,669	13,144,190	13,156,109

See accompanying notes to basic financial statements.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### **(1) Summary of Significant Accounting Policies**

The Commonwealth of Puerto Rico (the Commonwealth) was constituted on July 25, 1952, under the provisions of its Constitution as approved by the people of Puerto Rico and the U.S. Congress. The Commonwealth's Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government. The Commonwealth assumes responsibility for public safety, health, public housing and welfare, education, and economic development.

The accompanying basic financial statements of the Commonwealth have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The accompanying basic financial statements present the financial position of the Commonwealth and its various funds, the results of operations of the Commonwealth and its various funds and fund types, and the cash flows of the proprietary funds. The basic financial statements are presented as of June 30, 2007 and for the year then ended. The basic financial statements include the various departments, agencies, boards, commissions, public trusts and public corporations, and any other organizational units governed by the Puerto Rico Legislature and/or officers of the Commonwealth.

#### **(a) *The Financial Reporting Entity***

The accompanying basic financial statements include all departments, agencies, and governmental entities whose funds are under the custody and control of the Secretary of the Treasury of the Commonwealth and the Commonwealth's component units pursuant to Act No. 230 of July 23, 1974, as amended, known as Commonwealth of Puerto Rico Accounting Law. The Commonwealth has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Commonwealth to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Commonwealth.

As required by U.S. GAAP, these basic financial statements present the Commonwealth and its component units.

#### **(b) *Component Units***

Component units are entities that are legally separate organizations for which the Commonwealth's elected officials are financially accountable or other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading and incomplete. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Commonwealth's balances and transactions; or discrete presentation of the component units' financial data in columns separate from the Commonwealth's balances and transactions. The Commonwealth is financially accountable

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

because it appoints the members of the governing authorities of each of the component units and because it is able to impose its will on these organizations or because the organizations provide financial benefits or impose financial burdens on the Commonwealth. The financial statements of the component units discussed below have been included in the financial reporting entity either as blended component units or as discretely presented component units in accordance with GASB Statement No. 14, *The Financial Reporting Entity*, as amended by GASB Statement No. 39, *Determining Whether Certain Organization are Component Units*.

#### **Blended Component Units**

The following entities, while legally separate from the Commonwealth, meet the criteria to be reported as part of the primary government because they provide services entirely or almost entirely to the Commonwealth.

***Public Buildings Authority (PBA)*** – PBA is governed by a six-member board comprised by the Secretary of the Department of Transportation and the Public Works (DTPW), the Secretary of the Department of Education of the Commonwealth, the Interim President of the Government Development Bank for Puerto Rico (GDB), and three members appointed by the Governor of Puerto Rico with the advice and consent of the Senate. It is a legally separate entity, whose activities are blended within the primary government because it exists to construct, purchase, or lease office, school, health, correctional, social welfare, and other facilities for lease to the Commonwealth's departments, component units, and instrumentalities. Bonds issued by PBA to finance such facilities are payable from lease collections, which are largely derived from Commonwealth appropriations and are further secured by the Commonwealth's guaranty.

***Puerto Rico Maritime Shipping Authority (PRMSA)*** – PRMSA is governed by the President of GDB. The operations of PRMSA consist of servicing the long-term liability to third parties that resulted from the sale of certain maritime operations formerly owned and operated by PRMSA. The Commonwealth is required to annually appropriate funds in its general operating budget to provide for the payment of principal and interest on such debt [see note 14 (d)].

***The Children's Trust (the Trust)*** – The Trust is governed by a seven-member board comprised by the Governor, who designated the president of the board, the President of GDB, the Director of the Office of Management and Budget (OMB) of the Commonwealth, the Secretary of Justice of the Commonwealth, and three private citizens appointed by the Governor with the consent of the Senate. The Trust's sole operation consists of providing financial assistance principally to the Commonwealth's departments to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico, especially in the areas of education, recreation, and health. The operation of the Trust is financed with the moneys being received by the Commonwealth from a global settlement agreement (GSA) dated November 23, 1998 between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies shall continue making contributions in perpetuity.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

The blended component units are composed of various funds. The PBA capital projects fund and the Trust special revenue fund are presented as major governmental funds. All other funds are reported in the other governmental funds column. Complete financial statements of the blended component units can be obtained directly by contacting their respective administrative offices at:

Public Buildings Authority  
P.O. Box 41029 Minillas Station  
San Juan, PR 00940-1029

Puerto Rico Maritime  
Shipping Authority  
P.O. Box 42001  
San Juan, PR 00940-2001

The Children's Trust  
P.O. Box 42001  
San Juan, PR 00940-2001

### Discretely Presented Component Units

The following component units, consistent with GASB No. 14, are discretely presented in the basic financial statements because of the nature of the services they provide, the Commonwealth's ability to impose its will, principally through the appointment of their governing authorities, and because the component units provide specific financial benefits to, or impose financial burdens on, the Commonwealth. These have been classified by management between major and nonmajor component units. A major discretely presented component unit is defined as those component units that meet ten percent or more of total assets, liabilities, net assets, revenue or expenses of all discretely presented component units. If a component unit is expected to meet the minimum criteria for inclusion as major component unit in a future year, the Commonwealth may elect to report as a major component unit.

### Major Component Units

***Government Development Bank for Puerto Rico (GDB)*** – GDB is governed by a seven-member board appointed by the Governor. GDB acts as fiscal agent, depository of funds, disbursing agent, investor and financial advisor for the Commonwealth, its public corporations, and municipalities in connection with the issuance of bonds and notes; and it also makes loans and advances funds predominantly to the Commonwealth's departments, component units, and municipalities. GDB's board of directors' members are executives on a trustworthy position, named and supervised by the Governor.

***Puerto Rico Aqueduct and Sewer Authority (PRASA)*** – PRASA is governed by a nine-member board comprising five members appointed by the Governor, the Secretary of DTPW, the President of GDB, and two members elected in a referendum carried out by the Puerto Rico Consumer Affairs Department. PRASA owns and operates the system of public water supply and sanitary sewer facilities. PRASA is authorized, among other things, to borrow money and issue revenue bonds for any of its corporate purposes. Through the approval of Act No. 328 of 1998, as discussed in note 15(a), the Commonwealth guarantees the principal and interest payments of certain outstanding bonds and of all future bonds issued to refinance those outstanding bonds, and other loans under the State Revolving Fund Program (SRFP).

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

***Puerto Rico Electric Power Authority (PREPA)*** – PREPA is governed by a nine-member board comprising the Secretary of DTPW, six members appointed by the Governor with the consent of the Senate, and two members representing the consumers' interest elected in a referendum carried out by the Puerto Rico Consumer Affairs Department. Board members are appointed or elected for a period of four years. PREPA is responsible for conserving, developing, and utilizing the power resources of Puerto Rico and owns and operates the Commonwealth's electrical power generation, transmission, and distribution system. The Commonwealth provides financial support to PREPA through legislative appropriation.

***Puerto Rico Health Insurance Administration (PRHIA)*** – PRHIA is governed by a nine-member board comprising the Secretary of Health of the Commonwealth, the Secretary of the Treasury of the Commonwealth, and the Insurance Commissioner of Puerto Rico, being these members inherent by law, and six additional members appointed by the Governor, with the consent of the Senate. PRHIA was created for implementing, administering, and negotiating a health insurance system through contracts with insurance underwriters to provide quality medical and hospital care to low-income individuals, employees of the Commonwealth, and policemen who voluntarily subscribe to the Puerto Rico health insurance medical plan. The board of directors' president is elected by the Governor and all board of directors' members is executives on a trustworthy position. The Commonwealth provides financial support to PRHIA through legislative appropriations.

***Puerto Rico Highways and Transportation Authority (PRHTA)*** – PRHTA is governed by the Secretary of DTPW. PRHTA has broad powers to carry out its responsibilities in accordance with DTPW's overall transportation policies. These powers include, among other things, the complete control and supervision of any highway facilities constructed, owned, or operated by PRHTA, the ability to set tolls for the use of the highway facilities, and the power to issue bonds, notes, or other obligations. PRHTA plans and manages the construction of all major projects relating to the Commonwealth's toll highway system, undertakes major repairs, and maintains the toll ways. The Commonwealth has the ability to significantly influence rates charged by PRHTA.

***Puerto Rico Infrastructure Financing Authority (PRIFA)*** – PRIFA is governed by the board of directors of GDB and the Secretary of the Treasury of the Commonwealth. Its responsibilities are to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other component units and governmental instrumentalities of the Commonwealth, which are authorized to develop infrastructure facilities and to establish alternate means for financing them. PRIFA's boards of directors' members are executives on a trustworthy position, named and supervised by the Governor. The Commonwealth provides financial support to PRIFA through legislative appropriations.

***Puerto Rico Sales Tax Financing Corporation (known as COFINA by its Spanish acronym)*** – COFINA was created by Act No. 291 of December 26, 2006 as an independent governmental instrumentality to own and hold the dedicated sales tax fund (known as FIA by its Spanish acronym), for the purpose of financing the repayments and refundings of the Commonwealth's extra-constitutional debt. The FIA Fund was created by Act No. 91 of May 13, 2006 to receive and account for the first 1% of the new sales and use tax established as described in note 3(c). The members of the board of directors of COFINA are the same as the ones of GDB.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

***University of Puerto Rico (UPR)*** – UPR is governed by a thirteen-member board of trustees comprising one full-time student, two permanent professors, and ten community citizens of the private sector, of which at least one must be graduated from the institution. Community citizens are designated by the Governor with the advice and consent of the Senate. Members designated by the Governor are appointed for a period of four to eight years. The terms for the student and professors are one year. The Commonwealth provides financial support to UPR through legislative appropriations.

#### **Nonmajor Component Units**

***Agricultural Services and Development Administration (ASDA)*** – ASDA is governed by the Secretary of Agriculture of the Commonwealth. The purpose of ASDA is to provide a wide variety of services and incentives to the agricultural sector. The government has the ability to impose its will. The Commonwealth provides financial support to ASDA through legislative appropriations.

***Automobile Accidents Compensations Administration (AACA)*** – AACA is governed by a four-member board appointed by the Governor with the advice and consent of the Senate. AACA operates a system of compulsory insurance coverage for all registered motor vehicles and compensates citizens for injuries arising from motor vehicle accidents. The Commonwealth has the ability to significantly influence rates charged by AACA.

***Cardiovascular Center Corporation of Puerto Rico and the Caribbean (CCCPRC)*** – CCCPRC is governed by a five-member board comprising of the Secretary of Health of the Commonwealth, the Director of the Medical Sciences Campus of the UPR, the Executive Director of the Puerto Rico Medical Services Administration, and two additional members appointed by the Governor with the consent of the Senate, one of which should be from the Cardiology Society of Puerto Rico and another a member of a cardiology foundation properly registered in the Department of State of the Commonwealth. The purpose of the CCCPRC is to provide special treatment to patients suffering from cardiovascular diseases. The Commonwealth provides financial support to CCCPRC through legislative appropriations.

***Caribbean Basin Projects Financing Authority (CBPFA)*** – CBPFA is governed by a seven-member board comprising of the Secretary of State of the Commonwealth, the Executive Director of the Puerto Rico Industrial Development Company (PRIDCO), the President of GDB, the President of the Economic Development Bank for Puerto Rico (EDB), and three citizens, including at least two from the private sector, appointed by the Governor with the advice and consent of the Senate. CBPFA is authorized to issue revenue bonds and to lend the proceeds thereof to finance projects for the development of the Caribbean Basin countries that were authorized to receive investments of funds under the provisions of Section 936 of the U.S. Internal Revenue Code. The Commonwealth has access to CBPFA's resources.

***Culebra Conservation and Development Authority (CCDA)*** – CCDA is a component unit of the Commonwealth created by Law No. 66 of June 22, 1975, as amended, to formulate, adopt, and administer the program and plan for the conservation, use, and development of natural resources of the municipality of Culebra. CCDA is administered through a board of directors composed of seven members, including the Mayor of Culebra. The administration and operations of the CCDA are conducted by an executive director elected by the board of directors.



## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

***Economic Development Bank for Puerto Rico (EDB)*** – EDB is governed by a nine-member board comprising the President of GDB, who is the Chairman, the Secretary of Agriculture of the Commonwealth, the Secretary of the Department of Economic Development and Commerce of the Commonwealth, the Executive Director of the Puerto Rico Industrial Development Company, the Executive Director of the Tourism Company of Puerto Rico, and four other members representing the private sector and appointed by the Governor with the consent of the Senate. Private sector members are appointed for a maximum period of three years. EDB is responsible for the promotion and development of the private sector economy of the Commonwealth. This purpose is to be met by granting direct loans, loan guarantees, loan participation, and/or direct investments to any person or business organization devoted to manufacturing, agriculture, trade, tourism, or other service enterprises with preference to but not limited to economic activities that may have the effect of substituting imports. The Commonwealth has the ability to impose its will on this component unit.

***Employment and Training Enterprises Corporation (ETEC)*** – ETEC is governed by a consultant board, which includes two private citizens appointed by the Governor with the consent of the Senate. The purpose of ETEC is to provide training, management, development, and employment for inmates of the correctional institutions of the Commonwealth. The Commonwealth provides financial support to ETEC through legislative appropriations.

***Farm Insurance Corporation of Puerto Rico (FICPR)*** – FICPR is governed by a five-member board consisting of the Secretary of Agriculture of the Commonwealth, the Dean of the Agricultural Sciences Faculty of the UPR Mayaguez Campus, a representative of GDB, and two bona fide farmers appointed by the Governor with the consent of the Senate. The purpose of the FICPR is to provide insurance to farmers against losses in their farms caused by natural disasters.

***Fine Arts Center Corporation (FACC)*** – FACC is governed by a nine-member board comprising the President of the Musical Arts Corporation and eight members named by the Governor. FACC was created with the purpose of administering the Fine Arts Center. The Commonwealth provides financial support to FACC through legislative appropriations.

***Governing Board of the 9-1-1 Service (911 Service)*** – The Governing Board of 911 Service (the Board) is governed by a five-member board comprising the Chief of Police, the Executive Director of the Medical Emergency Services, the Director of the State Emergency Management Agency, the Chief of the Puerto Rico Firefighters Corps, and one member appointed by consensus of the four ex-officio members to represent the public interest. The 911 Service is responsible for providing an efficient service of fast response to emergency calls through the 911 number and transferring these to the appropriate response agencies using technological and human resources to safeguard lives and properties. The Commonwealth has access to 911 Service's resources.

***Institute of Puerto Rican Culture (IPRC)*** – The Institute is governed by a nine-member board comprising the President of Musical Arts Corporation and eight members appointed by the Governor with the advice and consent of the Senate. The Institute is responsible for implementing the public policy related to the development of Puerto Rican arts, humanities and culture. The Commonwealth provides financial support to IPRC through legislative appropriations.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

***Institutional Trust of the National Guard of Puerto Rico (ITNGPR)*** – ITNGPR is governed by a seven-member board comprising of the National Guard Special Assistant, the President of GDB, the Secretary of Justice of the Commonwealth, three militaries from the Puerto Rico National Guard, and one representative from the community recommended by the National Guard Special Assistant and appointed by the Governor. ITNGPR's purpose is to provide life insurance, retirement benefits, and economic assistance to the active members of the Puerto Rico National Guard and their families. The Commonwealth provides financial support to ITNGPR through legislative appropriations.

***Land Authority of Puerto Rico (LAPR)*** – LAPR is governed by a six-member board consisting of the Secretary of Agriculture of the Commonwealth and five members appointed by the Governor. LAPR was created to carry out the provisions of the Land Law of Puerto Rico. LAPR maintains debt that is paid with Commonwealth's appropriations.

***Musical Arts Corporation (MAC)*** – MAC is governed by a seven-member board appointed by the Governor with the consent of the Senate. MAC was created to promote the development of the arts and cultural programs of the Commonwealth. The Commonwealth provides financial support to MAC through legislative appropriations.

***National Parks Company of Puerto Rico (NPCPR)*** – NPCPR is governed by a nine-member board comprising the Secretary of Recreation and Sports of the Commonwealth (the Secretary), who is the chairman, the Secretary of Education of the Commonwealth, the Executive Director of the Puerto Rico Tourism Company (PRTC), the Secretary of Natural and Environmental Resources of the Commonwealth, and five members appointed by the Governor with the recommendation from the Secretary and with known interest in the development and preservation of parks in the private sector. NPCPR is responsible for the operation of all national parks and the protection, conservation, maintenance and use of parks, beaches, forests, and natural and historical monuments for the optimum enjoyment of present and future generations. The Commonwealth provides financial support to NPCPR through legislative appropriations.

***Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives (PCSDIPRC)*** – PCSDIPRC is governed by a nine-member board consisting of the Administrator of the Cooperative Development Administration, the Commissioner of Financial Institutions of Puerto Rico (the Commissioner of Financial Institutions), the Secretary of the Treasury of the Commonwealth, the Inspector of Cooperatives, three citizens representing the cooperative movement one representative of the Puerto Rico Cooperatives League, and one private citizen representing the public interest. PCSDIPRC has the responsibility of providing to all the cooperatives and the Federation of Cooperatives of Puerto Rico insurance coverage over the stocks and deposits, for monitoring the financial condition of the insured cooperatives, and of uninsured cooperatives when requested by the Commissioner of Financial Institutions.

***Puerto Rico Conservatory of Music Corporation (PRCMC)*** – PRCMC is governed by a six-member board appointed by the Governor, with the consent of the Senate. PRCMC is responsible for providing the Puerto Rican community and especially its youths with the required facilities to educate and perfect their musical skills, including secondary education programs for developing musical arts. It prepares the artistic element that nourishes the Puerto Rico Symphony Orchestra and other musical organizations, and coordinates the governmental efforts to interested industries, private

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

enterprises, and particular citizens. The Commonwealth provides financial support to PRCMC through legislative appropriations.

***Puerto Rico Convention Center District Authority (PRCCDA)*** – PRCCDA is governed by a board comprising of nine members, four of which shall be from the public sector and five from the private sector. The public sector members comprise the Secretary of Economic Development and Commerce of the Commonwealth, who is the Chairman, the Executive Director of the PRTC, the president of GDB, and one member from the public sector. The private sector members are individuals having experience in the areas of hospitality, tourism, real estate, or convention centers who are appointed by the Governor with the advice and consent of the Senate. PRCCDA was created to develop, own, finance, plan, design, construct, operate, manage, and promote the new Puerto Rico Convention Center and the Puerto Rico Convention District. The PRCCDA also has the ownership interest as well as other rights and obligations related to the development and operations of the Jose Miguel Agrelot Coliseum. The Commonwealth provides financial support to PRCCDA through legislative appropriations.

***Puerto Rico Council on Higher Education (PRCHE)*** – PRCHE is governed by a board comprising eight members appointed by the Governor with the consent of the Senate and the Secretary of Education of the Commonwealth as an ex-officio member. Its purpose is to develop higher education, to administer the licensing and certification of institutions of higher education, and to administer scholarship funds. The Commonwealth provides financial support to PRCHE through legislative appropriations.

***Puerto Rico Government Investment Trust Fund (PRGITF)*** – PRGITF is governed by the Secretary of the Treasury of the Commonwealth. GDB is its trustee, custodian, and administrator. PRGITF's main objective is to provide investment opportunities in a professionally managed money market portfolio by investing in high-quality securities with minimal credit risk. Qualified investors include the Commonwealth's central government, its public corporations, instrumentalities and agencies, and the municipalities of Puerto Rico. In conformity with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*, the financial statements of the PRGITF are not included in the accompanying basic financial statements because the primary government and each component unit investor is already presenting as cash or investment their corresponding share of the assets of the PRGITF (see note 5).

***Puerto Rico Industrial Development Company (PRIDCO)*** – PRIDCO is governed by a seven-member board comprising the Secretary of Economic Development and Commerce of the Commonwealth, who is the Chairman, the Secretary of the Treasury of the Commonwealth, the President of GDB, the President of the Planning Board of Puerto Rico, and three members from the private sector appointed by the Governor with the advice and consent of the Senate. The private sector members are appointed for a period of four years. PRIDCO administers the Commonwealth-sponsored economic development program by providing facilities, general assistance, and special incentive grants to manufacturing companies operating in Puerto Rico. PRIDCO has issued interim notes and revenue bonds to finance manufacturing plants and other facilities. Rentals derived from the leasing of specified facilities of PRIDCO are pledged for the payment of PRIDCO's revenue bonds. PRIDCO maintains debt that is paid with Commonwealth's appropriations.

## COMMONWEALTH OF PUERTO RICO

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***Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (known as AFICA by its Spanish acronym)*** – AFICA is governed by a seven-member board consisting of the Secretary of Economic Development and Commerce, the President of GDB, the Executive Director of PRIFA, the Executive Director of the PRTC, the President of the Environmental Quality Board, and two private citizens appointed by the Governor. AFICA is authorized to issue revenue bonds to finance industrial, tourist, environmental control, medical, and educational facilities in Puerto Rico and the United States of America for use by private companies, nonprofit entities, or governmental agencies. The bonds are payable solely from collections from such private companies, nonprofit entities, or governmental agencies, and do not constitute debt of the Commonwealth or any of its other component units. The Commonwealth has access to AFICA's resources. AFICA maintains debt that is paid with Commonwealth's appropriations.

***Puerto Rico Land Administration (PRLA)*** – PRLA is governed by an eight-member board comprising the Secretary of Economic Development and Commerce of the Commonwealth, who serves as president, the Secretary of the Treasury of the Commonwealth, the Secretary of Agriculture of the Commonwealth, the Secretary of DTPW of the Commonwealth, the Secretary of Housing of the Commonwealth, the President of the Planning Board of Puerto Rico, and two other members appointed by the Governor with the consent of the Senate. PRLA acquires parcels of land on behalf of government instrumentalities through negotiation or expropriation. The Commonwealth provides financial support to the PRLA through legislative appropriations.

***Puerto Rico Medical Services Administration (PRMSA)*** – PRMSA is governed by a ten-member board comprising the Secretary of Health of the Commonwealth, who is the Chairman, the Dean of the Medical Sciences Faculty of the UPR, the President of the Board of the Puerto Rican Cancer Society, the Mayor of the municipality of San Juan, the Administrator of the State Insurance Fund Corporation (SIFC), the Executive Director of PRMSA, the Administrator of the Administration of Mental Health and Anti-Addiction Services, the President of the Medical Policy and Administration Committee, and two consumers appointed by the Secretary of Health of the Commonwealth. Its purpose is to plan, organize, operate, and administer the centralized health services, provided in support of the hospital and other functions, offered by the member institutions and users of the medical complex known as the Puerto Rico Medical Center. The Commonwealth provides financial support to PRMSA through legislative appropriations.

***Puerto Rico Metropolitan Bus Authority (PRMBA)*** – PRMBA is governed by the Secretary of DTPW of the Commonwealth. PRMBA provides bus transportation to passengers within the San Juan Metropolitan Area. The Commonwealth provides financial support to PRMBA through legislative appropriations.

***Puerto Rico Municipal Finance Agency (PRMFA)*** – PRMFA is governed by a five-member board comprising the President of GDB, who is the Chairman, the Commissioner of Municipal Affairs, and three additional members appointed by the Governor, one of whom shall be either the mayor or chief financial officer of a municipality. PRMFA was organized to create a capital market to assist the municipalities of Puerto Rico in financing their public improvement programs.

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***Puerto Rico Ports Authority (PRPA)*** – PRPA is governed by a five-member board consisting of the Secretary of DTPW of the Commonwealth, who is the Chairman, the Secretary of Economic Development and Commerce of the Commonwealth, the Administrator of the Economic Development Administration, the Executive Director of the PRTC, and one private citizen appointed by the Governor with the consent of the Senate. The purpose of PRPA is to administer all ports and aviation transportation facilities of the Commonwealth and to render other related services. The Commonwealth provides financial support to PRPA through legislative appropriations.

***Puerto Rico Public Broadcasting Corporation (PRPBC)*** – PRPBC is governed by an eleven-member board of directors comprising the Secretary of Education of the Commonwealth, the President of the UPR, the Executive Director of IPRC, and eight private citizens appointed by the Governor with the advice and consent of the Senate. At least three of these private citizens must have proven interest, knowledge, and experience in education, culture, art, science, or radio and television. PRPBC was created for the purpose of integrating, developing, and operating the radio, television, and electronic communication facilities that belong to the Commonwealth. The Commonwealth provides financial support to PRPBC through legislative appropriations.

***Puerto Rico School of Plastic Arts (PRSPA)*** – PRSPA is governed by a seven-member board. Four members are appointed by the board of directors of IPRC, representing the public educational and cultural interests. Board members may not be employees of the PRSPA. The remaining three members are elected from among the members of the board of directors of IPRC, one of whom will serve as president. PRSPA was created to develop, promote, plan, and coordinate programs of study in higher education oriented to the plastic arts, teaching, artistic techniques, and to help students to develop humanistic values. The Commonwealth provides financial support to PRSPA through legislative appropriations.

***Puerto Rico Solid Waste Authority (PRSWA)*** – PRSWA is governed by a government board appointed by the Secretary of the Department of Natural Resources, whereby, the Secretary and the Executive Director of PRSMA periodically meet. PRSWA provides alternatives for processing of solid waste and encourages recycling, reuse, and recovery of resources from waste. The Commonwealth provides financial support to PRSWA through legislative appropriations.

***Puerto Rico Telephone Authority (PRTA)*** – PRTA is governed by a five-member board comprising the President of GDB and four members that are appointed by the board of directors of GDB. PRTA is the legal entity responsible to account for the equity interest in Telecomunicaciones de Puerto Rico, Inc. for the benefit of the Employees' Retirement System of the Government of Puerto Rico and its instrumentalities (ERS). The Commonwealth provides financial support to PRTA through legislative appropriations.

***Puerto Rico Tourism Company (PRTC)*** – PRTC is governed by a seven-member board comprising representatives of different tourist-related sectors appointed by the Governor with the consent of the Senate. At least one member must represent internal tourism and two must not be residents of the metropolitan area. Its purpose is to promote the tourism industry of Puerto Rico. The Commonwealth provides financial support to PRTC through legislative appropriations.

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***Puerto Rico Trade and Export Company (PRTEC)*** – PRTEC is governed by an eight-member board comprising the Secretary of Department of Economic Development and Commerce, who is the Chairman, the Executive Director of the Ports Authority, the Secretary of the Department of Agriculture, the President of EDB, the Executive Director of PRIDCO, the Legal Division Director of PRTEC, and two private citizens. PRTEC has the responsibility to promote the highest efficiency in the services provided to the commercial sector, with emphasis on small- and medium-sized enterprises while promoting the export of products and services from Puerto Rico to other countries. The Commonwealth provides financial support to PRTEC through legislative appropriations.

***Right to Employment Administration (REA)*** – REA is governed by an administrator appointed by the Governor with the consent of the Senate. The Commonwealth provides financial support to REA through legislative appropriations and federal funds.

***Special Communities Perpetual Trust (SCPT)*** – SCPT is governed by a board of directors composed of eleven members: the Secretary of Housing of the Commonwealth, the Secretary of the DTPW of the Commonwealth, the Coordinator for the Social and Economic Financing of the Special Communities, one mayor of a municipality of Puerto Rico, one community leader resident in one special community, four private citizens representing the public interest, and two public employees. All members of the board of directors are appointed by the Governor. SCPT's principal purpose is to fund development projects that address the infrastructure and housing needs of the underprivileged communities. The Commonwealth provides financial support to SCPT through legislative appropriations.

***State Insurance Fund Corporation (SIFC)*** – SIFC is governed by a six-member board appointed by the Governor with the advice and consent of the Senate. The board comprises the Commissioner of Insurance of Puerto Rico, an officer from the Department of Labor and Human Resources of the Commonwealth, an officer from the Department of Health of the Commonwealth (DOH), a representative of the employer's interest, a representative of the employees' interest, and two members without any of these interests. One of these members is appointed by the Governor as president of the board for a period of six years. The three public officials are appointed for a period of five years, and the rest of the members for four, three, two, and one year, respectively. SIFC provides workers' compensation and disability insurance to public and private employees. The Commonwealth has access to SIFC's resources.

Complete financial statements of the discretely presented component units can be obtained directly by contacting their administrative offices:

Government Development Bank for Puerto Rico  
P.O. Box 42001  
San Juan, PR 00940 – 2001

Puerto Rico Electric Power Authority  
P.O. Box 364267  
San Juan, PR 00936-4267

Puerto Rico Aqueduct and Sewer Authority  
P.O. Box 7066  
San Juan, PR 00916-7066

Puerto Rico Health Insurance Administration  
P.O. Box 195661  
San Juan PR 00919-5661

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Puerto Rico Highways and Transportation  
Authority  
P.O. Box 42007  
San Juan, PR 00940-2007

Puerto Rico Sales Tax Financing Corporation  
P.O. Box 42001  
San Juan PR 00940-2001

Agricultural Services and Development  
Administration  
P.O. Box 9200  
San Juan, PR 00908-0202

Cardiovascular Center Corporation of  
Puerto Rico and the Caribbean  
P.O. Box 366528  
San Juan, PR 00936-6528

Culebra Conservation and Development  
Authority  
P.O. Box 217  
Culebra, PR 00775-0217

Employment and Training Enterprises  
Corporation  
P.O. Box 366505  
San Juan, PR 00936-6505

Fine Arts Center Corporation  
P.O. Box 41287 – Minillas Station  
San Juan, PR 00940-1287

Institute of Puerto Rican Culture  
P.O. Box 9024184  
San Juan, PR 00902-4184

Puerto Rico Infrastructure Financing Authority  
Capital Center  
235 Ave. Arterial Hostos, Suite 1600  
San Juan, PR 00918-1433

University of Puerto Rico  
Jardin Botanico Sur 1187  
Calle Flamboyán  
San Juan, PR 00926-1117

Automobile Accidents Compensations  
Administration  
P.O. Box 364847  
San Juan, PR 00936-4847

Caribbean Basin Projects Financing Authority  
P.O. Box 42001  
San Juan, PR 00940-2001

Economic Development Bank for Puerto Rico  
P.O. Box 2134  
San Juan, PR 00922-2134

Farm Insurance Corporation of Puerto Rico  
P.O. Box 9200  
Santurce, PR 00908

Governing Board of the 9-1-1 Service  
P.O. Box 270200  
San Juan, PR 00927-0200

Institutional Trust of the National Guard of  
Puerto Rico  
P.O. Box 9023786  
San Juan, PR 00902-3786

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Land Authority of Puerto Rico  
P.O. Box 9745  
San Juan, PR 00908-9745

National Parks Company of Puerto Rico  
P.O. Box 902098  
San Juan, PR 00902-2089

Puerto Rico Conservatory of Music Corporation  
350 Lamar Street and Roosevelt Avenue  
San Juan, PR 00918-2199

Puerto Rico Council on Higher Education  
P.O. Box 19900  
San Juan, PR 00910-1900

Puerto Rico Industrial Development Company  
P.O. Box 362350  
San Juan, PR 00936-2350

Puerto Rico Land Administration  
P.O. Box 363767  
San Juan, PR 00936-3767

Puerto Rico Metropolitan Bus Authority  
P.O. Box 195349  
San Juan, PR 00919-5349

Puerto Rico Ports Authority  
P.O. Box 362829  
San Juan, PR 00936-2829

Puerto Rico School of Plastic Arts  
P.O. Box 9021112  
San Juan, PR 00902-1112

Puerto Rico Telephone Authority  
P.O. Box 42001  
San Juan, PR 00940-2001

Musical Arts Corporation  
P.O. Box 41227 – Minillas Station  
San Juan, PR 00940-1227

Public Corporation for the Supervision and  
Deposit Insurance of Puerto Rico Cooperatives  
P.O. Box 195449  
San Juan, PR 00919-5449

Puerto Rico Convention Center District Authority  
P.O. Box 19269  
San Juan, PR 00910-1269

Puerto Rico Government Investment Trust Fund  
P.O. Box 42001 – Minillas Station  
San Juan, PR 00940-2001

Puerto Rico Industrial, Tourist, Educational,  
Medical, and Environmental Control  
Facilities Financing Authority  
P.O. Box 42001  
San Juan, PR 00940-2001

Puerto Rico Medical Services Administration  
P.O. Box 2129  
San Juan, PR 00922-2129

Puerto Rico Municipal Finance Agency  
P.O. Box 42001  
San Juan, PR 00940

Puerto Rico Public  
Broadcasting Corporation  
P.O. Box 19-0909  
San Juan, PR 00919-0909

Puerto Rico Solid Waste Authority  
P.O. Box 40285 – Minillas Station  
San Juan, PR 00940-0285

Puerto Rico Tourism Company  
P.O. Box 902-3960  
Old San Juan Station  
San Juan, PR 00902-3960



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Puerto Rico Trade and Export Company  
P.O. Box 195009  
San Juan, PR 00919-5009

Right to Employment Administration  
P.O. Box 364452  
San Juan, PR 00936-4452

Special Communities  
Perpetual Trust  
P.O. Box 42001  
San Juan, PR 00940-2001

State Insurance Fund  
Corporation  
P.O. Box 365028  
San Juan, PR 00936-5028

The financial statements of the discretely presented component units have a year-end of June 30, 2007, except for the Puerto Rico Telephone Authority, which has a year-end of December 31, 2006.

#### **Fiduciary Component Units**

The three employee retirement systems administer pension funds for the Commonwealth and its political subdivisions. The three systems are subject to legislative and executive controls, and the administrative expenses are subject to legislative budget controls. These component units, while meeting the definition of a component unit and are legally separate, are presented in the fund financial statements along with other fiduciary funds of the Commonwealth. They have been omitted from the government-wide financial statements.

***Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS)*** – ERS is governed by a board of trustees, which is composed of the Secretary of the Treasury of the Commonwealth, who is the President, the President of GDB, the Commissioner for Municipal Affairs, the Director of the Puerto Rico Central Office of Personnel Administration, two participating employees, and one retiree, who are appointed by the Governor. The Commonwealth reports ERS as a single-employer pension plan. ERS is the administrator of a defined-benefit pension plan, which covers all regular employees of the Commonwealth and its instrumentalities and of certain municipalities and component units not covered by their own retirement systems. On September 24, 1999, an amendment to the law that created ERS was enacted with the purpose of establishing a new defined-contribution plan (System 2000) for employees hired by the government on or after January 1, 2000.

***Puerto Rico Judiciary Retirement System (JRS)*** – JRS is governed by the same board of trustees as ERS. JRS is a single-employer defined-benefit plan, administered by ERS, which covers all individuals holding a position as Justice of the Supreme Court, Judge of the Superior Court or the District Court, or Municipal Judges of the Commonwealth.

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***Puerto Rico System of Annuities and Pensions for Teachers (TRS)*** – TRS is governed by a nine-member board comprising the Secretary of Education of the Commonwealth, the Secretary of the Treasury of the Commonwealth, the President of GDB, two active teachers (one of them is a representative of the teachers' organization according to Act No. 45 of February 1998), two retired teachers, one representative of the teachers' organization, and one representative of the public interest appointed by the Governor with the advice and consent of the Senate for four years. The Commonwealth reports TRS as a single-employer pension plan. TRS provides retirement benefits to all teachers of the Department of Education of the Commonwealth, all pensioned teachers, all teachers transferred to an administrative position in the Department of Education of the Commonwealth, teachers who work in the Teachers' Association of Puerto Rico, and those who practice in private institutions accredited by the Department of Education of the Commonwealth. TRS provides retirement, death, and disability benefits.

Complete financial statements of these component units can be obtained directly by contacting their respective administrative offices at:

Employees' Retirement System of the  
Government of Puerto Rico and its  
Instrumentalities  
P.O. Box 42003 – Minillas Station  
Santurce, PR 00940

Puerto Rico Judiciary  
Retirement System  
P.O. Box 42003 – Minillas Station  
Santurce, PR 00940

Puerto Rico System of Annuities and Pensions for  
Teachers  
P.O. Box 191879  
San Juan, PR 00919-1879

#### **(c) *Government-wide Financial Statements***

The government-wide financial statements (the statement of net assets and the statement of activities) report information of all of the nonfiduciary activities of the Commonwealth and its component units. For the most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from the legally separate component units for which the primary government is financially accountable. The statement of net assets presents the reporting entities' nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- ***Invested in Capital Assets, Net of Related Debt*** – These consist of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

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- ***Restricted Net Assets*** – These result when constraints placed on net assets' use on either externally imposed by creditors, grantors, contributors, and the like or imposed by law through constitutional provisions or enabling legislation.
- ***Unrestricted Net Assets*** – These consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, generally, it is the Commonwealth's policy to use restricted resources first, then the unrestricted resources as they are needed.

The statement of activities demonstrates the degree to which the direct expenses of a given function, segment, or component unit are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function, segment, or component unit. Program revenue includes charges to customers who purchase, use, or directly benefit from goods or services provided by a given function, segment, or component unit. Program revenue also includes grants and contributions that are restricted to meeting the operational or capital requirements of a particular function, segment, or component unit. Taxes and other items not properly included among program revenue are reported instead as general revenue. Resources that are dedicated internally are reported as general revenue rather than as program revenue. The Commonwealth does not allocate general government (indirect) expenses to other functions.

**(d) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation***

***Government-wide Financial Statements*** – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

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## Notes to Basic Financial Statements

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***Governmental Fund Financial Statements*** – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified-accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. Principal revenue sources considered susceptible to accrual include tax revenue, net of estimated overpayments (refunds) and amounts considered not collectible, which are recorded as taxpayers earn income (income taxes), as sales are made (consumption, sales and use taxes) and as cash is received (miscellaneous taxes). For this purpose, the Commonwealth considers income tax revenue to be available if collected within 120 days after the end of the current fiscal year-end and consumption sales and are tax if collected within 30 days after the end of the current fiscal year. In applying the susceptible to accrual concept to federal grants, there are essentially two types of revenue. For the majority of grants, moneys must be expended by the Commonwealth on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employees' vested annual vacation and sick leave are recorded as expenditures when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2007 has been reported only in the government-wide financial statements.
- Interest and principal on general long-term obligations are recorded when due, except for interest and principal due on July 1 of the following fiscal year, if resources are available for its payment as of June 30.
- Executory purchase orders and contracts are recorded as a reservation of fund balance.
- Debt service expenditures, federal funds' cost disallowances, other long-term obligations, and amounts subject to judgments under litigation are recorded only when payment is due.

***Proprietary Funds, Fiduciary Funds, and Discretely Presented Component Units Financial Statements*** – The financial statements of the proprietary funds, fiduciary funds, and discretely presented component units are reported using the economic measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

Each enterprise fund has the option under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless these conflict with a GASB pronouncement. The primary government's major enterprise funds have elected not to apply FASB pronouncements issued after November 30, 1989 and two nonmajor enterprise funds elected to adopt the FASB's pronouncements issued after November 30, 1989. Also, certain discretely presented component units have disclosed their election in their separately issued financial statements. The component units follow U.S. GAAP

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as issued by GASB and FASB as applicable to each component unit based on the nature of their operations. In addition, the Puerto Rico Government Investment Trust Fund adopted GASB Statement No. 31; *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*; however, such financial statements are not included in the accompanying basic financial statements because the primary government and each component unit's investor already present their corresponding share of the assets of the PRGITF as cash or investments.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses. The major operating revenue of the Commonwealth enterprise funds is as follows:

- Unemployment Insurance Fund – Amounts requisitioned for the Puerto Rico Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits and charges made to individual employers.
- Lotteries Fund – Amounts collected from the sale of traditional lottery tickets and electronic lotto games.

#### (e) *Fund Accounting*

The Commonwealth reports its financial position and results of operations in funds, which are considered separate accounting entities, and discrete presentations of those component units, which are not required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. Major funds are determined using a predefined percentage of the assets, liabilities, revenue, or expenditures/expenses of either the fund category or the governmental and enterprise funds combined. The nonmajor funds are combined in a single column in the fund financial statements. The Commonwealth reports the following major funds:

#### **Governmental Funds**

**General Fund** – The general fund is the primary operating fund of the Commonwealth. It is used to account for all financial transactions, except those required to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, and education.

**Debt Service Fund** – The debt service fund accounts for the accumulation of resources predominantly for, and the payment of, general long-term bonds' principal, interest, and related costs other than bonds payable from the operations of proprietary fund types, pension trust funds, and discretely presented component units. Long-term debt and interest due on July 1 of the following fiscal year are accounted for as a fund liability if resources are available as of June 30 for its payment.

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***Public Buildings Authority's Capital Projects Fund*** – The Public Buildings Authority's capital projects fund is used to account for the financial resources used for the acquisition or construction of major capital facilities not financed by proprietary fund types, pension trust funds, and discretely presented component units.

***The Children's Trust Special Revenue Fund*** – The Children's Trust special revenue fund is used to account for the moneys received by the Commonwealth from a global settlement agreement dated November 23, 1998 between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The financial resources received by this fund are used to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico.

#### **Proprietary Funds**

These funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to the general public.

***Unemployment Insurance Fund*** – This fund accounts for amounts requisitioned for the Puerto Rico Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits and charges made to individual employers.

***Lotteries Fund*** – This fund accounts for the assets and operations of two lottery systems administered by the Commonwealth.

#### **Fiduciary Funds**

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity, or as an agent for individuals, private organizations, and other governmental units. The following are the Commonwealth's fiduciary funds:

***Pension Trust Funds*** – These are used to account for the assets, liabilities, and net assets available for pension benefits held in trust for the public employees' retirement systems.

***Agency Funds*** – These are custodial in nature (assets equal liabilities) and do not involve measurement of the results of operations.

#### **Discretely Presented Component Units**

Discrete presentation of component units is used to present the financial information of entities that do not qualify to be blended, in accordance with GASB No. 14 as amended by GASB No. 39, with the funds of the primary government. The component units column in the government-wide financial statements is used to report the financial activities of the Commonwealth's discretely presented component units. The financial statements of these component units are presented following the accrual basis of accounting. Under the accrual basis, revenue is recognized when earned and expenses are recorded as liabilities when incurred, without regard to receipt or payment of cash.

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**(f) *Statutory (Budgetary) Accounting***

The Commonwealth's budget is adopted in accordance with a statutory basis of accounting, which is not in accordance with GAAP. Revenue is generally recognized when cash is received, net of tax refunds claimed by taxpayers as of year-end. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenue. Expenditures are generally recorded when the related expenditure is incurred or encumbered. Encumbrances generally lapse the year following the end of the fiscal year when the encumbrance was established, as established by Act No. 123 of August 17, 2001, which amended the then-existing appropriations and encumbrances lapsing provisions of Act No. 230 of July 23, 1974. Unencumbered appropriations lapse at year-end. Amounts required for settling claims and judgments against the Commonwealth and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment.

Under the statutory basis of accounting, the Commonwealth uses encumbrance accounting to record the full amount of purchase orders, contracts, and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control.

The statement of revenue and expenditures – budget and actual – budget basis – general fund only presents the information for the general fund for which there is a legally adopted budget, as required by GAAP. See note 3 for a reconciliation of the statement of revenue and expenditures – budget and actual – budget basis – general fund with the statement of revenue, expenditures, and changes in fund balance (deficit) for the general fund. The special revenue funds do not have a legally mandated budget.

**(g) *Cash and Short-Term Investments***

The Commonwealth follows the practice of pooling cash. The balance in the pooled cash accounts is available to meet current operating requirements, and any excess is invested in various interest-bearing accounts with GDB and with the PRGITF. Cash and cash equivalents include investments with original maturities of 90 days or less from the date of acquisition.

The Commissioner of Financial Institutions requires that private financial institutions deposit collateral securities to secure the deposits of the Commonwealth and all other governmental entities in each of these institutions. The amount of collateral securities to be pledged for the security of public deposits shall be established by the rules and regulations promulgated by the Commissioner of Financial Institutions.

The Puerto Rico Unemployment Insurance Trust Fund is maintained to account for the collection of unemployment insurance contributions from employers and the payment of unemployment benefits to eligible claimants. As required by federal law, all resources not necessary for current benefit payments are placed on deposit with the U.S. Treasury. Interest earned over such deposit is retained in the fund.

Cash and short-term investments and cash equivalents of the component units are maintained in separate bank accounts, from those of the primary government, in their own names.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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**(h) *Securities Purchased under Agreements to Resell***

Certain component units of the Commonwealth enter into purchases of securities with simultaneous agreements to resell. The securities underlying these agreements mainly consist of U.S. government obligations, mortgage-backed securities, and interest-bearing deposits with other banks.

**(i) *Securities Lending Transactions***

Certain component units of the Commonwealth enter into securities lending transactions in which governmental entities (lenders) transfer their securities to broker-dealers and other entities (borrowers) for collateral with a simultaneous agreement to return the collateral for the same securities in the future. Securities received as collateral are generally reflected as investments with a corresponding liability resulting from the obligation to return such collateral.

**(j) *Investments***

Investments include U.S. government and agencies' obligations, mortgage-backed securities, repurchase agreements, commercial paper, local government obligations, investment contracts, and corporate debt and equity obligations. Investment securities, including investments in limited partnerships, are presented at fair value, except for money market investments and participating investment contracts with a remaining maturity at the time of purchase of one year or less and nonparticipating investment contracts, which are presented at cost. Changes in the fair value of investments are presented as investment earnings in the statement of activities, the statement of revenue, expenditures, and changes in balance – governmental funds, and the statement of revenue, expenses, and changes in fund net assets – proprietary funds. Fair value is determined based on quoted market prices. When securities are not listed on national exchanges, quotations are obtained from brokerage firms.

The PRGITF is considered a 2a7-like external investment pool and, as such, reports its investments at amortized cost.

The reverse repurchase agreements reported by certain discretely presented component units are authorized transactions under their respective enabling legislation and authorized by GDB.

**(k) *Receivables***

Tax receivables in the general fund include predominantly amounts owed by taxpayers for individual and corporate income taxes, net of estimated uncollectible amounts. Income tax receivables are recognized as revenue when they become measurable and available based on actual collections during the 120 days following the fiscal year-end related to tax returns due before year-end. Tax receivables also include amounts owed by taxpayers on income earned in periods prior to June 30, 2007, estimated to be collectible but not currently available, and thus are reported as deferred revenue in the general fund. Unemployment, disability, and driver's insurance receivables in the enterprise funds are stated net of estimated allowances for uncollectible accounts. During the fiscal year 2007 the Commonwealth started imposing a general sales and use tax. The sales and use tax receivable is recognized as revenue when it becomes measurable and available based on actual collections during the 30 days following the fiscal year-end related to sales and use tax returns due before year-end.



## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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Accounts receivable are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables primarily represent amounts owed to the Commonwealth for reimbursement of expenditures incurred pursuant to federally funded programs. Intergovernmental receivables also include taxes that the Municipal Revenue Collection Center (CRIM, as per its Spanish acronym), a municipal corporation, is required to remit to the Commonwealth to be used by the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth. The amount to be remitted is based on the special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation, which is levied by the CRIM.

The accounts receivable from nongovernmental customers of the component units are net of estimated uncollectible amounts. These receivables arise primarily from service charges to users. Accounts receivable from the primary government and other component units that arise from service charges do not have allowances for uncollectible accounts, as these are deemed fully collectible.

Loans of the general fund represent predominantly amounts owed by public corporations and municipalities for public insurance and rent paid by the general fund on their behalf.

The loans of the pension trust funds do not have allowances for uncollectible amounts since such loans are secured by mortgage deeds, plan members' contributions, and any unrestricted amounts remaining in escrow. Loans of the component units consist predominantly of loans to the primary government, other component units, and municipalities, and do not have allowances for uncollectible accounts as those are deemed fully collectible. The remaining loans of the component units are to small and medium businesses, agricultural, and low-income housing loans from nongovernmental customers, and are presented net of estimated losses on such portfolios.

#### **(l) *Inventories***

Generally, inventories are valued at cost and predominantly on the first-in, first-out basis. Governmental fund inventories are recorded as expenditures when purchased rather than capitalized as an asset. Only significant amounts of inventory at the end of the year are capitalized in the governmental funds. However, inventories are always capitalized in the statement of net assets of governmental activities.

#### **(m) *Restricted Assets***

Funds set aside for the payment and guarantee of notes and interest payable and for other specified purposes are classified as restricted assets since their use is limited for this purpose by applicable agreements or required by law. Restricted assets in the proprietary funds mainly include amounts set aside for the payment of insurance benefits.

#### **(n) *Real Estate Held for Sale***

Real estate held for sale are carried at the lower of fair value or cost, which is established by a third-party professional assessment or based upon an appraisal, minus estimated costs to sell. Subsequent declines in the value of real estate available for sale are charged to expenditure/expense.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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### (o) *Capital Assets*

Capital assets, which include land, buildings, building improvements, equipment, vehicles, construction in process, and infrastructure assets, are reported in the applicable governmental, business-type activities, and component unit columns in the government-wide financial statements. The Commonwealth's primary government defines capital assets as assets that have an initial, individual cost of \$25,000 or more at the date of acquisition and have a useful life of five or more years. Capital assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available.

The method to deflate the current cost of the same or a similar asset using an approximate price index was used to estimate the historical cost of certain land, buildings, and building improvements, because invoices and similar documentation were no longer available in certain instances. Donated capital assets are recorded at fair market value at the time of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest costs are capitalized during the construction period only for business-type activities and most component units. The costs of normal maintenance and repairs that do not add value to the assets or materially extend asset lives are not capitalized.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds and component units' financial statements.

Capital assets of the primary government are depreciated on the straight-line method over the assets' estimated useful life. There is no depreciation recorded for land and construction in progress. The estimated useful life of capital assets is as follows:

	<u>Years</u>
Buildings and building improvements	20 – 50
Equipment, furniture, fixtures, and vehicles	5 – 15
Infrastructure	50

The capital assets of the component units are recorded in accordance with the applicable standards of the component units and under their own individual capitalization thresholds. Depreciation has been recorded when required by these standards based on the types of assets, use and estimated useful lives of the respective assets, and on the nature of each of the component unit's operations.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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The estimated useful lives of capital assets reported by the component units are as follows:

	<u>Years</u>
Buildings and building improvements	3 – 50
Equipment, furniture, fixtures, and vehicles	3 – 20
Infrastructure	10 – 50

The Commonwealth follows the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries—an amendment to GASB Statement No. 34*. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

**(p) Tax Refunds Payable**

During the calendar year, the Commonwealth collects individual income taxes through withholdings and payments from taxpayers. At June 30, the Commonwealth estimates the amount owed to taxpayers for overpayments during the first half of the calendar year. These estimated amounts and the actual tax refunds claimed for prior years but not paid at year-end are recorded as tax refunds payable and as a reduction of tax revenue.

**(q) Deferred Revenue**

Deferred revenue at the governmental fund level arises when potential revenue does not meet either the “measurable” or the “available” criteria for revenue recognition in the current period. Deferred revenue also arises when resources are received before the Commonwealth has a legal claim to them, as when grant moneys are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Commonwealth has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet, and the revenue is recognized. Deferred revenue at the government-wide and proprietary fund levels arises only when the Commonwealth receives resources before it has a legal claim to them.

**(r) Long-Term Debt**

The liabilities reported in the government-wide financial statements include Commonwealth’s general obligation bonds and long-term notes, obligations under lease/purchase agreements, and long-term liabilities including vacation, sick leave, long-term liabilities to other governmental entities, net pension obligation, legal claims, and noncurrent federal fund cost disallowances related to expenditures of federal grants. Long-term obligations financed by proprietary fund types and component units are recorded as liabilities in those funds and in the discretely presented component units column.

Premiums, discounts, and issuance costs – in the government-wide financial statements, long-term debt, and other long-term obligations – are presented in the columns for governmental and business-type activities. The same is presented in the proprietary fund financial statements. Bond and note premiums and discounts, as well as issuance costs, are deferred and amortized over the life of

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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the debt. Bonds and notes payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges in other assets and are amortized over the term of the related debt. In the governmental fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

**(s) *Reservations of Fund Balance – Governmental Funds***

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. Reserves for encumbrances, debt service, and other specific purposes are examples of the latter.

**(t) *Accounting for Pension Costs***

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*, the Commonwealth's financial reporting entity is considered to be a sponsor of three single-employer defined-benefit pension plans: ERS, JRS, and the TRS. This is because substantially all the participants in the three pension trust funds are part of the financial reporting entity of the Commonwealth. For the purpose of the basic financial statements, and as disclosed in note 19, the Commonwealth's annual pension cost, measured on the accrual basis of accounting, for the year ended June 30, 2007 amounted to approximately \$999 million. However, the amount recognized as pension expenditure in the governmental funds was recorded under the modified accrual basis, and amounted to approximately \$641 million. The excess of the annual required contribution over the statutorily required contributions increased the net pension obligation at June 30, 2007 to approximately \$5.1 billion. This amount is presented in the statement of net assets of the governmental activities as of June 30, 2007.

For purposes of the stand-alone financial statements of each of the blended and discretely presented component units, the entities accounted for pension costs from the standpoint of a participant in a multiple-employer cost sharing plan. Accordingly, pension costs recognized are equal to the statutorily or contractually required contributions, with a liability recorded for any unpaid required contributions. The basis of accounting used by the component units was either modified accrual basis or accrual basis, depending upon individual fund structure and type of entity. Most component units did not have pension-related assets or liabilities at transition because they have contributed the statutorily required contributions.

**(u) *Postemployment Benefits***

In addition to the pension benefits described in note 19, the Commonwealth provides postemployment healthcare benefits, Summer bonus, and a Christmas bonus for its retired employees in accordance with local law. Substantially, all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Commonwealth. Healthcare benefits are provided through insurance companies whose premiums are paid by the retiree with the Commonwealth providing a matching share of not more than \$100 per month for each retiree.

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During the year ended June 30, 2007, the cost of providing healthcare benefits amounted to approximately \$148 million for approximately 123,594 retirees. The Christmas bonus paid to these retired employees during the year ended June 30, 2007 was \$400 per retiree and the total amount was approximately \$49 million. These benefits are recorded as expenditures when paid in the general fund. The summer bonus paid to these retired employees during the year ended June 30, 2007 was \$100 per retiree and the total amount was approximately \$12 million. These benefits are recorded as an expense in the pension trust fund. During the year ended June 30, 2007, the Commonwealth implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43, which establishes uniform financial reporting standards for other postemployment benefits (OPEB) plans. This statement applies for OPEB trust funds of a plan sponsor or governmental unit employer as well as for stand-alone reports of OPEB plans. For multiple-employer OPEB plans, GASB Statement No. 43 is effective one year prior to the effective date of the related financial statements for the largest participating employer in the plan. The adoption of this statement did not have a significant impact in the accompanying basic financial statements.

(v) ***Compensated Absences***

The vacation policy of the Commonwealth generally provides for the accumulation of 2.5 days per month, except for the teachers who accrue 4 days per month. Vacation time accumulated is fully vested to the employees from the first day of work up to a maximum of 60 days. Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated unpaid leave at the current rate, if the employee has at least 10 years of service with the Commonwealth. Accrued compensated absences of the primary government at June 30, 2007 amounting to approximately \$1.8 billion is presented in the statement of net assets. Compensated absence accumulation policies for the blended component units and discretely presented component units vary from entity to entity based on negotiated agreements and other factors agreed upon between the management of these entities and their employees.

The Public Service Personnel Law requires certain component units and the primary government of the Commonwealth to annually pay the employees the accumulated vacation and sick leave earned in excess of the limits mentioned above.

(w) ***Interfund and Intraentity Transactions***

The Commonwealth has the following types of transactions among funds:

***Interfund Transfer*** – Legally required transfers that are reported when incurred as transfer-in by the recipient fund and as transfer-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivable and payable are considered internal balances and activities that have been eliminated in the government-wide financial statements.

***Intraentity Transactions*** – There are two types of intraentity transactions. First, are resource flows between the primary government and its component units and among the component units. These

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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resource flows and related outstanding balances are reported as if they were external transactions. However, resource flows between the primary government and blended component units are classified as interfund transactions, as described above. Second, are intraentity balances between the primary government funds and discretely presented component units that are tantamount to long-term debt financing. The primary government's liability is reported in the statement of net assets, the proceeds in the primary government's funds, and the asset in the discretely presented component units' statement of net assets.

**(x) *Lottery Revenue and Prizes***

The revenue, expenses, and prizes awarded by the Lottery of Puerto Rico and the Additional Lottery System, reported within the lotteries enterprise fund, are recognized as drawings are held. Moneys collected prior to June 30 for tickets related to drawings to be conducted subsequent to June 30 are reported as deferred revenue. Unpaid prizes awarded as of June 30 are reported as a fund liability. Unclaimed prizes expire after six months and are transferred to the general fund.

**(y) *Risk Management***

The Commonwealth purchases commercial insurance covering casualty, theft, tort claims, and other losses for the primary government, most component units, and the municipalities. The Commonwealth is reimbursed for premium payments made on behalf of the component units and the municipalities. The current insurance policies have not been canceled or terminated. For workers' compensation, the Commonwealth has a discretely presented component unit, the SIFC, which provides workers' compensation to both public and private employees. In the past three years, the Commonwealth has not settled claims that exceed insurance coverage.

Certain component units combine commercial insurance with internal self-insurance funds covering specific risks related to their specialized operations.

**(z) *GASB Technical Bulletin No. 2004-1***

The Trust follows GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issue* (the TB), which provides accounting guidance for entities created to obtain the rights to all or a portion of future tobacco settlement resources and for the governments that create such entities.

The TB indicates that the entity created to obtain the rights, which is called the Tobacco Settlement Authority (TSA), should be considered a component unit of the government that created it and the component unit should be blended. The TB also states that the government receiving the payments from the tobacco companies under the agreement, which are called settling governments, should recognize a receivable and revenue for tobacco settlement resources (TSRs) when an event occurs. The event that results in the recognition of an asset and revenue by the settling government is the domestic shipment of cigarettes. The TB indicates that accruals should be made by the settling government and TSAs for estimated shipments from January 1 to their respective fiscal year-ends, since the annual payments are based on a calendar year. However, under the modified accrual basis of accounting at the fund level, revenue should be recognized only to the extent that resources are available.

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**(aa) *Reclassifications***

Certain reclassifications have been made to the information presented in the separately issued financial statements of certain blended component units and agencies included within the special revenue, debt service, capital projects, proprietary funds, and discretely presented component units to conform to the accounting classifications used by the Commonwealth in the basic financial statements.

**(bb) *Use of Estimates***

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**(cc) *Future Adoption of Accounting Pronouncements***

The GASB has issued the following accounting standards that have effective dates after June 30, 2007:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement establishes standards for the measurement, recognition, and display of OPEB, expense/expenditures and related liabilities (assets), notes disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of the state and local governmental employers. This Statement is effective for periods beginning after December 15, 2006.
- GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. This statement establishes criteria that governments will use to ascertain whether the proceeds received from the sale and pledge of receivables and future revenues should be reported as revenue or as a liability. Also, this Statement includes a provision that governments should not revalue assets that are transferred between financial reporting entity components. This Statement is effective for periods beginning after December 15, 2006.
- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement is effective for periods beginning after December 15, 2007.
- GASB Statement No. 50, *Pension Disclosures*. This statement amends GASB Statements No. 25 and 27 to require defined benefit pension plans, and sole and agent employers present the following information in their financial statements: (1) disclose the funded status of the plan as the most recent actuarial valuation date; (2) disclose the funded status of the plan, and a schedule of funding progress as required supplementary information

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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(RSI), using the entry age actuarial cost method (aggregate actuarial cost method used); (3) include a reference linking the funded status disclosure in the notes to financial statements to the required schedule of funding progress in RSI; (4) if actuarial assumptions are different for successive years, disclose the initial and ultimate rates. This Statement is effective for periods beginning after June 15, 2007.

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. This Statement is effective for periods beginning after June 15, 2009.
- GASB Statement No. 52, *Land and Other Real Estates Held as Investment by Endowments*. This statement requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the method and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported as fair value. This Statement is effective for periods beginning after June 15, 2008.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pensions and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers*. As it relates to pension transactions, this technical bulletin became effective for financial statements for periods ended after December 15, 2004. As it relates to OPEB transactions, it is effective for financial statements for periods beginning after December 15, 2006. The effect of this technical bulletin on the accompanying basic financial statements was not considered material as it relates to pension transactions.

The impact of these statements on the Commonwealth's basic financial statements has not yet been determined.

### (2) Component Units

The Commonwealth follows the provisions of GASB Statement No. 14, as amended by GASB Statement No. 39. The basic financial statements of the Commonwealth include the financial statements of the following component units that were audited by other auditors:

Blended component units:

Public Buildings Authority  
Puerto Rico Maritime Shipping Authority  
The Children's Trust

Discretely presented component units:

Agricultural Services and Development Administration  
Automobile Accidents Compensations Administration  
Cardiovascular Center Corporation of Puerto Rico and the Caribbean  
Caribbean Basin Projects Financing Authority  
Culebra Conservation and Development Authority



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Employment and Training Enterprises Corporation  
Farm Insurance Corporation of Puerto Rico  
Fine Arts Center Corporation  
Governing Board of the 9-1-1 Service  
Government Development Bank for Puerto Rico  
Institute of Puerto Rican Culture  
Institutional Trust of the National Guard of Puerto Rico  
Land Authority of Puerto Rico  
Musical Arts Corporation  
National Parks Company of Puerto Rico  
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives  
Puerto Rico Conservatory of Music Corporation  
Puerto Rico Convention Center District Authority  
Puerto Rico Council on Higher Education  
Puerto Rico Electric Power Authority  
Puerto Rico Government Investment Trust Fund  
Puerto Rico Health Insurance Administration  
Puerto Rico Highways and Transportation Authority  
Puerto Rico Industrial Development Company  
Puerto Rico Industrial, Tourist, Educational, Medical, Environmental  
Control Facilities Financing Authority  
Puerto Rico Infrastructure Financing Authority  
Puerto Rico Land Administration  
Puerto Rico Medical Services Administration  
Puerto Rico Metropolitan Bus Authority  
Puerto Rico Municipal Finance Agency  
Puerto Rico Ports Authority  
Puerto Rico Public Broadcasting Corporation  
Puerto Rico School of Plastic Arts  
Puerto Rico Solid Waste Authority  
Puerto Rico Telephone Authority  
Puerto Rico Tourism Company  
Puerto Rico Trade and Export Company  
Right to Employment Administration  
Special Communities Perpetual Trust  
State Insurance Fund Corporation  
University of Puerto Rico

#### Fiduciary component units:

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities  
Puerto Rico Judiciary Retirement System  
Puerto Rico System of Annuities and Pension for Teachers

## COMMONWEALTH OF PUERTO RICO

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#### (3) Stewardship, Compliance, and Accountability

##### (a) *Budgetary Control*

The Governor is constitutionally required to submit to the Legislature an annual balanced budget of the Commonwealth for the ensuing fiscal year. The annual budget is prepared by the Commonwealth's OMB and takes into consideration the advice provided by the Puerto Rico Planning Board (annual economic growth forecasts and four-year capital improvements plan), the Department of the Treasury of the Commonwealth (revenue estimates, accounting records, and the comprehensive annual financial report), GDB (fiscal agent), and other governmental offices and agencies. Section 7 of Article VI of the Constitution of Puerto Rico provides that "The appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for the said fiscal year, unless the imposition of taxes sufficient to cover the said appropriations is provided by law."

The annual budget, which is developed utilizing elements of program budgeting, includes an estimate of revenue and other resources for the ensuing fiscal year under: (1) laws existing at the time the budget is submitted; and (2) legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year capital improvements plan adopted by the Puerto Rico Planning Board.

The Legislature may amend the budget submitted by the Governor but may not increase any items so as to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. Upon passage by the Legislature, the budget is referred to the Governor who may decrease or eliminate any line item but may not increase or insert any new line item in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Legislature and the Governor, is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This permits the Commonwealth to continue making payments for its operating and other expenses until the new budget is approved. The appropriated annual budget for fiscal year 2007 amounted to approximately \$5.6 billion. The Legislature also made several special budgetary appropriations to the general fund throughout the year, which amounted to approximately \$3.8 billion.

The OMB has authority to amend the budget within a department, agency, or government unit without legislative approval.

For budgetary purposes, encumbrance accounting is used. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of budgetary appropriations within GAAP fund balances and do not constitute expenditures or liabilities on a GAAP basis because the commitments will be honored during the subsequent year. The unencumbered balance of any appropriation of the general fund at the end of the fiscal year lapses immediately. Appropriations, other than in the general fund, are continuing accounts for which the

## COMMONWEALTH OF PUERTO RICO

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Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

During any fiscal year in which the resources available to the Commonwealth are insufficient to cover the appropriations approved for such year, the Governor may take administrative measures to reduce expenses and submit to both houses of the Legislature a detailed report of any adjustment necessary to balance the budget, or make recommendations to the Legislature for new taxes or authorize borrowings under provisions of existing legislation or take any other necessary action to meet the estimated deficiency. Any such proposed adjustments shall give effect to the “priority norms” established by law for the disbursement of public funds in the following order of priority; first, the payment of the interest on and amortization requirements for public debt (Commonwealth general obligations and guaranteed debt for which the Commonwealth’s guarantee has been exercised); second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain, and other unavoidable obligations to protect the name, credit and good faith of the Commonwealth; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purpose.

In addition, the Legislature may direct that certain revenue be retained and made available for spending within a specific appropriation account. Generally, expenditures may not exceed the level of spending authorized for an individual department. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated. Appropriations are enacted for certain departments, agencies, and government units included in the balance sheet of the general fund. For these funds, a statement of revenue and expenditures – budget and actual budget basis – general fund is included. Appropriations for capital projects are made for each bond issue and the authorization continues for the expected construction period.

The OMB has the responsibility to ensure that budgetary spending control is maintained on an individual department basis. OMB may transfer part or all of any unencumbered balance within a department to another department subject to legislative approval. Budgetary control is exercised through the Puerto Rico Integrated Financial Accounting System (PRIFAS). PRIFAS ensures that encumbrances or expenditures are not processed if they exceed the department’s total available spending authorization, which is considered its budget. The legal level of budgetary control is at the individual department level for general fund expenditures, principal and interest due for the year for the debt service fund, and by bond authorization for capital expenditures.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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**(b) Budget/GAAP Reconciliation**

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity, timing, and basis differences in the excess (deficiency) of revenue and other financing sources over expenditures and other financing uses for the year ended June 30, 2007 is presented below for the general fund (expressed in thousands):

Excess of expenditures and other financing uses over revenue and other financing sources – budget basis	\$ (504,864)
Entity differences:	
Excess (deficiency) of revenue and other financing sources over expenditures and other financing uses for:	
Nonbudgeted funds	705,449
Inclusion of agencies with independent treasuries	(97,287)
Timing differences:	
Adjustment for encumbrances	73,908
Current year expenditure against prior year encumbrances	(39,370)
Basis of accounting differences:	
Net increase in taxes receivable (net of tax funds)	66,039
Net increase in other receivables	(60,549)
Net decrease in deferred revenue	(270,729)
Excess of expenditures and other financing uses over revenue and other financing sources – GAAP basis	\$ <u>(127,403)</u>

The Commonwealth's original budgeted expenditures (including transfers) for fiscal year 2007 of \$9.488 billion exceeded projected revenues of \$9.163 billion by approximately \$325 million. The Commonwealth expected to cover this budget deficit through the implementation of additional expenditure reducing measures, a possible increase in tax revenues resulting from the reduction of the uncertainty surrounding the government's fiscal crisis, and cash management mechanisms. The possible increase in tax revenues was tempered by the adverse economic impact resulting from increases in the price of oil and the implementation of the sales and use tax.

**(c) Deficit Net Assets**

The following activities, funds, and discretely presented component units reflect deficit fund balance/net assets at June 30, 2007 (expressed in thousands):

Primary government:	
Governmental activities	\$ 18,438,894
General fund	511,158
PBA capital projects fund	34,222
Enterprise fund – lotteries	153,144

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#### Component units:

Puerto Rico and Sales Tax Financing Corporation	\$	175,190
Land Authority of Puerto Rico		109,521
Agricultural Services and Development Administration		106,881
Puerto Rico Medical Services Administration		58,971
Cardiovascular Center Corporation of Puerto Rico and the Caribbean		37,896
Employment and Training Enterprises Corporation		7,066
Puerto Rico Tourism Company		3,511
Right to Employment Administration		2,121
Musical Arts Corporation		1,788

The Commonwealth's governmental activities show a deficit of approximately \$18.4 billion, mostly attributed to long-term obligations amounting to approximately \$28 billion, which are recognized in the statement of net assets. On the other hand, the discretely presented component units report net assets of approximately \$13.2 billion. This inverse relationship between the governmental activities and component units' net assets reveal the operational structure of the Commonwealth where the primary government issues debt, the proceeds of which are predominantly transferred to the component units and to other governments as well, that are not presented in these basic financial statements, to finance their capital projects and other operational needs. The Commonwealth includes within the annual budgetary appropriation process the necessary funds to cover the annual debt service requirements of the aforementioned debt, most of which are the result of Act No. 164 of December 17, 2001, described in note 14(d). Also, as part of the fiscal reform referred to below, certain component units will be subject to reductions in future legislative appropriations provided by the primary government, requiring the affected component units to increase their revenue base and fee structure currently being charged to the general public.

In an effort to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Executive Branch and the Legislature enacted and the Governor signed legislation providing for tax reform and fiscal reforms. The tax reform legislation is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based sales and use tax further as explained below. The fiscal reform legislation is aimed at limiting expenditures in relation to past spending rates and stabilizing expenditure growth at a level below that of recurring revenues.

On July 4, 2006, the Legislature approved Act No. 117 (Act 117), which amended the Puerto Rico Internal Revenue Code of 1994 (the PR Code), to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the Central Government Sales Tax). Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5% (the Municipal Sales Tax and, together with the Central Government Sales Tax, the Sales Tax). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods), and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets. Act 117 repealed the 5.0% general excise tax imposed on imported goods and on goods manufactured in Puerto Rico. Certain items, such as fuel, crude oil, and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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and will not be subject to the Sales Tax. The effective date of the repeal of the 5.0% general excise tax was October 17, 2006, pursuant to Act 229.

The Sales Tax became effective on November 15, 2006. Municipalities, however, were authorized to implement the Municipal Sales Tax starting on July 1, 2006, and some did so. The revenues derived from the Sales Tax are distributed as follows: (i) municipal governments will retain 1.5% of the Sales Tax, (ii) the FIA Fund, created by Act No. 91 of May 13, 2006, will receive 1.0% of the Sales Tax, and (iii) the general fund receives 4.5% of the Sales Tax. The revenues to be generated by the Sales Tax will be partly offset by the partial elimination of the 5.0% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provided for special income tax rates with respect to certain transactions occurred on and between July 1, 2006 and December 31, 2006. These special tax rates applied to eligible dividends declared by domestic corporations or partnerships and “built-in” gains associated with capital assets held for periods in excess of six months, as well as certain withdrawals from retirement accounts. These special tax rates were only available for transactions in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. In the case of resident corporations and partnerships, these special tax rates applied only to real property located in Puerto Rico.

The Additional Lottery System (electronic Lotto Games) activities show a deficit of approximately \$153 million, mostly attributed to a payment amounting to \$200 million made in 2004 to the Commonwealth. This transaction was authorized pursuant to Act No. 171, dated July 29, 2004, which among other things authorized the Secretary of the Treasury of the Commonwealth to provide funding for the payment of lotto prize annuities upon depletion of other resources available at the Additional Lottery System. It is the opinion of the additional lottery management that the deficiency is not an indication of financial difficulties for the payment of long-term lotto prizes because funds will be provided from either the Additional Lottery System or from financial assistance provided by the Commonwealth.

#### (4) Changes in Reporting Entity and Restatement

The following table illustrates the change to net assets at the beginning of the year as previously reported in the governmental activities’ statement of net assets and to fund balances at the beginning of the year as reported in the statement of revenue, expenditures, and changes in fund balances – governmental funds. The changes resulted from the effect of a net understatement in capital assets amounting to \$14.7 million. The beginning balances have been restated as follows (expressed in thousands):

	<b>Net assets – governmental activities</b>
Beginning balance, as previously reported	\$ (17,209,563)
Noncapitalization of capital assets	<u>14,680</u>
Beginning balance, as restated	<u><u>\$ (17,194,883)</u></u>

## COMMONWEALTH OF PUERTO RICO

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The following table summarizes changes to net assets at the beginning of the year as previously reported in the statement of net assets by certain discretely presented component units. The changes resulted primarily from exclusions of nonmajor component units in the current year's presentation, and restatements to correct errors in the prior year's financial statements of certain component units (expressed in thousands):

Beginning net assets, as previously reported	\$ 13,084,624
Restatements of nonmajor component units audited by other auditors	(21,514)
Nonmajor component unit audited by other auditors excluded in fiscal year 2006, but included in fiscal year 2007	<u>81,080</u>
Beginning net assets, as restated	<u>\$ 13,144,190</u>

All of the above restatements arise from component units that were audited by other auditors (note 2).

#### (5) Puerto Rico Government Investment Trust Fund (PRGITF)

PRGITF was created by Act No. 176, of August 11, 1995, and began operations on December 4, 1995. PRGITF is a no-load diversified collective investment trust administered by GDB that was created for the purpose of providing eligible governmental investors of Puerto Rico with a convenient and economical way to invest in a professionally managed money market portfolio. PRGITF is not an investment company or a mutual fund and is not subject to regulation or registration under the investment company Act of 1940. Units issued by PRGITF are not subject to regulation or registration under the Securities and Exchange Act of 1933, as amended, because the units are issued by a government entity. The deposits on hand and the investments purchased are not collateralized, secured, or guaranteed by the Commonwealth or any of its agencies, instrumentalities, or political subdivisions.

PRGITF is considered a 2a7-like external investment pool, and as such, reports its investment at amortized cost.

The investment securities on hand at June 30, 2007 consisted of certificates of deposit, bank notes, corporate obligations, commercial paper, and U.S. government and agencies obligations, all of which may be considered highly liquid. However, the participants' investments are subject to the ability of PRGITF to receive payment from the securities' issuer when due. The liquidity of certain investments and changes in interest rates may affect PRGITF's yield and the fair value of its investments.

# COMMONWEALTH OF PUERTO RICO

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The dollar amount of the deposits on hand at June 30, 2007 at \$1.00 per unit of participation, was reported in the individual financial statements of each of the participants, and combined in the basic financial statements as follows (expressed in thousands):

	<u>Balance outstanding</u>	<u>Percentage of total</u>
Primary government:		
Commonwealth	\$ 298,461	77.02%
The Children's Trust	48,972	12.64
Public Buildings Authority	82	0.02
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	2	—
Total for primary government	<u>347,517</u>	<u>89.68</u>
Discretely presented component units:		
Puerto Rico Aqueduct and Sewer Authority	18,024	4.65
Government Development Bank for Puerto Rico	14,519	3.75
Institutional Trust of National Guard of Puerto Rico	3,691	0.95
Puerto Rico Highways and Transportation Authority	181	0.05
Puerto Rico Land Administration	643	0.17
Puerto Rico Solid Waste Authority	589	0.15
State Insurance Fund Corporation	435	0.11
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	431	0.11
Puerto Rico Infrastructure Financing Authority	208	0.05
Puerto Rico Electric Power Authority	528	0.14
	<u>39,249</u>	<u>10.13</u>
Other governmental entities	<u>762</u>	<u>0.19</u>
Total for all participants	<u>\$ 387,528</u>	<u>100.00%</u>

The deposits at June 30, 2007 were invested in securities with a cost that approximates fair value, plus accrued interest, for approximately \$387.5 million. The external portion of PRGITF was not considered significant for separate reporting in the accompanying basic financial statements.

Following is a table of the investments and other assets held at June 30, 2007, presented at amortized cost (in thousands):



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Commercial paper	\$	129,203
U.S. government and agencies' obligations		81,400
Securities purchased under agreements to resell		67,638
Corporate obligations		40,146
Certificates of deposits		55,200
Time deposits		12,000
Interest receivable		1,941
Total	\$	<u>387,528</u>

### (6) Deposits and Investments

Pursuant to the provisions of Act No. 91 of March 29, 2004 the primary government may invest in different types of securities, including domestic, international, and fixed income securities, among others.

The primary government maintains a cash and investment pool that is available for use by all funds, except for the fiduciary funds. Each fund's portion of this pool is reported on the statement of net assets as cash and cash equivalents. The fiduciary funds investments are held and managed separately from those of other primary government funds.

#### *Primary Government*

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, bank investment contracts, and deposits invested in PRGITF (see note 5).

The carrying amount of deposits of the primary government at June 30, 2007 consists of the following (expressed in thousands):

	Carrying amount			Bank
	Unrestricted	Restricted	Total	balance
Commercial banks and U.S.				
Treasury	\$ 244,729	720,425	965,154	1,477,758
Component unit banks	1,545,941	1,392,826	2,938,767	2,669,076
Total	<u>\$ 1,790,670</u>	<u>2,113,251</u>	<u>3,903,921</u>	<u>4,146,834</u>

Custodial credit risk is the risk that in the event of bank failure, the primary government's deposit might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by banks in the Commonwealth's name. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

At year-end, the Commonwealth's bank balance of deposits in commercial banks amounting to \$936 million was covered by federal depository insurance or by collateral held by the Commonwealth's agent in the Commonwealth's name. Deposits of approximately \$541 million with the U.S. Treasury represent unemployment insurance taxes collected from employers that are transferred to the federal Unemployment Insurance Trust Fund in the U.S. Treasury. These deposits are uninsured and

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uncollateralized. The bank balance of deposits in component unit banks, which as of June 30, 2007 amounted to approximately \$2.7 billion are also uninsured and uncollateralized. These deposits in component unit's banks are maintained with GDB and EDB. Deposits maintained in GDB and EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk, because in the event of GDB's or EDB's failure, the Commonwealth may not be able to recover these deposits.

Deposits in component units banks represent the balance of interest and noninterest-bearing accounts in GDB and EDB. The deposit liability at GDB and EDB is substantially related to deposits from other component units and of the Commonwealth. The deposit liability does not agree with the governmental cash balances shown above because of reconciling items such as outstanding checks and deposits in transit.

The bank balance of GDB's and EDB's deposits at June 30, 2007 is broken down as follows (expressed in thousands):

Primary government	\$ 2,239,589
Discretely presented components units	<u>1,840,875</u>
Total pertaining to the Commonwealth	4,080,464
Municipalities of Puerto Rico	567,727
Other nongovernmental entities	911,172
Certificates of indebtedness	11,800
Escrow accounts	<u>186,498</u>
Total deposits per GDB and EDB	<u>\$ 5,757,661</u>

Unrestricted deposits include approximately \$298.5 million that are invested in PRGIF (see note 5). Such amount has been included as cash and cash equivalents in the primary government's statement of net assets.

### Investments

#### *Custodial Credit Risk*

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the transaction, the primary government may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2007, securities investments were registered in the name of the Commonwealth and were held in the possession of the Commonwealth's custodian bank.

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## Notes to Basic Financial Statements

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### Primary Government

The fair value by investment type, credit quality ratings, and maturity of the unrestricted investments reported by the governmental activities at June 30, 2007 consist of the following (expressed in thousands):

	Fair market value	Investment rating		Maturity less than one year
		AAA to A	Not rated	
Investment pool	\$ 31,178	31,178	—	31,178
Guaranteed investment contract	83,685	83,685	—	83,685
PRGIF	48,972	48,972	—	48,972
Other	65	65	—	65
Total investments	\$ 163,900	163,900	—	163,900

### Business-type Activities

The fair value by investment type, credit quality ratings, and maturity of the restricted investments reported by the business-type activities at June 30, 2007 consists of the following (expressed in thousands):

	Fair value	Investment rating		
		AAA to A	BBB+	Not rated
Mortgage-backed securities	\$ 5,132	1,676	—	3,456
U.S. government and agency securities	8,044	8,044	—	—
U.S. equity securities	12,199	12,199	—	—
U.S. corporate debt securities	5,216	4,527	689	—
Other	5,015	5,015	—	—
Total	\$ 35,606	31,461	689	3,456

	Fair value	Maturity (in years)			
		Less than 1 year	1 to 5 years	6 to 10 years	More than 10 years
Mortgage-backed securities	\$ 5,132	—	—	—	5,132
U.S. government and agency securities	8,044	—	6,797	—	1,247
U.S. equity securities	12,199	12,199	—	—	—
U.S. corporate debt securities	5,216	—	—	5,216	—
Other	5,015	1,697	1,185	—	2,133
Total	\$ 35,606	13,896	7,982	5,216	8,512

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### *Component Units*

Cash, and cash equivalents, of the component units at June 30, 2007 consist of (expressed in thousands):

	<b>Carrying amount</b>		<b>Bank balance</b>
	<b>Unrestricted</b>	<b>Restricted</b>	
Commercial banks	\$ 3,135,274	867,106	4,002,380
Component unit banks	629,592	798,283	1,427,875
Total	\$ 3,764,866	1,665,389	5,430,255
			5,480,137

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

Custodial credit risk is the risk that, in the event of bank failure, the component unit's deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

Deposits maintained in GDB and EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of GDB's or EDB's failure, the Commonwealth may not be able to recover the deposits.

The component units were exposed to the following custodial credit risk arising from the balance of deposits maintained in commercial and component unit banks at June 30, 2007 (expressed in thousands):

Uninsured and uncollateralized	\$ 4,485,688
Uninsured and collateralized, with securities held by the pledging financial institutions	957,339
Uninsured and collateralized, with securities held by the pledging financial institutions but not in the component unit's name	37,110
Total	\$ 5,480,137

### **Investments**

The component units' investment policies allow management to purchase or enter into the following investment instruments:

- U.S. government and agencies obligations
- Certificates and time deposits
- Bankers' acceptances
- Obligations of the Commonwealth of Puerto Rico and municipalities

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- Federal funds sold
- Securities purchased under agreements to resell
- World Bank securities
- Corporate debt, including investment contracts
- External investment pools
- Stock of corporations created under the laws of the United States of America or the Commonwealth
- Options, futures, and interest-rates swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products that qualify under any of the foregoing investment categories.
- Open-end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or AAA by Moody's Investors Service
- A few component units, principally SIFC, are also allowed to enter into foreign currency investments, under certain limitations

The component units' investment policies establish limitations and other guidelines on amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country. In addition, such policies provide guidelines on the institutions with which investment transactions can be entered into.

The component units' investment policies provide that investments transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by the Standard & Poor's or equivalent rating by Fitch or Moody's Investors Service, depending on the type and maturity of the investment and the counterparty to the transaction. Also, the investment policy specifies that no more than 5% of a manager's assets at fair value shall be invested in the securities of any single issuer.

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All investments in U.S. Treasury securities and mortgage-backed securities guaranteed by GNMA carry the explicit guarantee of the U.S. government and are presented as “not rated” in the table below. The credit qualifying ratings for investments held by the component units at June 30, 2007 are as follows (expressed in thousands):

	Fair value			Investment rating		
	Unrestricted	Restricted	Total	Rating AAA to A	BBB+	Not rated
Mortgage-backed securities	\$ 392,498	823,382	1,215,880	1,204,260	265	11,355
U.S. government and agency securities	1,120,902	1,748,253	2,869,155	2,867,473	—	1,682
U.S. sponsored agencies notes	210,574	614,124	824,698	824,698	—	—
Negotiable certificates of deposit	255,987	434,999	690,986	624,581	—	66,405
U.S. corporate stocks	76,069	19,927	95,996	19,927	—	76,069
Non-U.S. corporate stocks	22,027	1,850	23,877	—	—	23,877
U.S. corporate bonds	473,604	74,979	548,583	454,473	84,466	9,644
Commercial paper	10,369	—	10,369	—	10,369	—
Repurchase agreement	20,000	—	20,000	20,000	—	—
Puerto Rico agencies and municipal bonds	8,810	1,423,398	1,432,208	9,741	1,422,467	—
Money market fund	188,016	46,646	234,662	234,662	—	—
Guaranteed investment contract	75,618	1,638,505	1,714,123	998,529	679,743	35,851
PRGITF	15,216	—	15,216	14,786	—	430
Investment pool	339,453	—	339,453	199,441	111,589	28,423
Security lending transactions	207,999	—	207,999	149,018	—	58,981
Investment in other equity securities	472,635	—	472,635	—	—	472,635
Other	148,884	59,097	207,981	6,029	129,986	71,966
Total investments	\$ 4,038,661	6,885,160	10,923,821	7,627,618	2,438,885	857,318

Certain component units classified approximately \$24 million of investments presented in PRGITF as cash and cash equivalents.

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The following table summarizes the type and maturities of investments held by the component units at June 30, 2007 (expressed in thousands):

	Fair value	Maturity (in years)				
		Less than 1 year	1 – 5 years	6 – 10 years	More than 10 years	No stated maturity date
Mortgage-backed securities	1,215,880	5,601	105,438	155,850	948,991	—
U.S. government and agency securities	2,869,155	135,288	268,581	227,922	2,237,364	—
U.S. sponsored agencies notes	824,698	115,831	625,127	82,656	1,084	—
Negotiable certificates of deposit	690,986	690,986	—	—	—	—
U.S. corporate stocks	95,996	—	—	—	—	95,996
Non-U.S. corporate stocks	23,877	—	—	—	—	23,877
U.S. corporate bonds	548,583	72,301	238,928	149,019	88,335	—
Commercial paper	10,369	10,369	—	—	—	—
Repurchase agreement	20,000	—	20,000	—	—	—
Puerto Rico agencies and municipal bonds	1,432,208	96,572	374,958	439,295	521,383	—
Money market fund	234,662	187,552	—	—	464	46,646
Guaranteed investment contract	1,714,123	883,688	35,851	—	794,584	—
PRGITF	15,216	15,216	—	—	—	—
Investment pool	339,453	311,365	—	—	—	28,088
Security lending transactions	207,999	149,018	—	—	—	58,981
Investment in other equity securities	472,635	—	—	—	410,840	61,795
Other	207,981	81,015	60,909	—	—	66,057
Total investments	\$ 10,923,821	2,754,802	1,729,792	1,054,742	5,003,045	381,440

The component units were exposed to the following custodial credit risk for investments held at June 30, 2007 (expressed in thousands):

Insured or registered	\$ 2,653,914
Uninsured and registered, with securities held by the counterparty's trust department or agent in the component units' name	8,173,872
Uninsured and unregistered, with securities held by the counterparty's trust department or agent, but not in the component units' name	96,035
Total	\$ 10,923,821

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### Foreign Currency Risk

SIFC limits its exposure to foreign currency risk by limiting the total amount invested to 5% of the portfolio. The SIFC investments were presented as follow (in thousands):

<u>Investment type</u>	<u>Local currency</u>	<u>Fair value</u>
Money market funds	British pound	\$ 61
	Hong Kong dollar	73
	Japanese yen	158
		<u>\$ 292</u>
Common stocks	British pound	\$ 16,733
	Canadian dollar	1,603
	Danish krone	853
	European monetary unit	20,738
	Hong Kong dollar	2,177
	Japanese yen	15,653
	Norwegian krone	890
	Swedish krone	3,024
	Swiss franc	6,768
	Euro	800
		<u>\$ 69,239</u>

Unrestricted repurchase agreements of approximately \$20 million belong to EDB. As of June 30, 2007, the fair value of the collateral for the repurchase agreements amounted to approximately \$20 million for EDB, which consisted primarily of investment securities held in custody by EDB's agent.

### Fiduciary Funds

Cash and cash equivalents of the fiduciary funds at June 30, 2007 consist of the following (expressed in thousands):

	<u>Carrying amount</u>			<u>Bank balance</u>
	<u>Unrestricted</u>	<u>Restricted</u>	<u>Total</u>	
Commercial banks and U.S. Treasury	\$ 730,952	—	730,952	731,252
Component unit banks	459,407	2,310	461,717	468,838
Total	<u>\$ 1,190,359</u>	<u>2,310</u>	<u>1,192,669</u>	<u>1,200,090</u>

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.



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### *Custodial Risk*

Custodial credit risk is the risk that, in the event of a bank failure, the fiduciary funds' deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

Deposits maintained in component unit banks are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of the component unit bank's failure, the Commonwealth may not be able to recover these deposits.

As of June 30, 2007, \$279.4 million was exposed to custodial credit risk. Cash exposed to foreign currency risk as of June 30, 2007 is as follows (expressed in thousands):

Investment type	Currency	Fair value at U.S. dollar currency
Foreign currency	Euro	\$ 916
Foreign currency	Danish krone	507
Foreign currency	Pound sterling	79
Foreign currency	Japanese yen	75
Foreign currency	Australian dollar	39
Foreign currency	Singapore dollar	5
		<u>\$ 1,621</u>

### *Investments*

The investment policies of the pension trust funds limit the investment in corporate debt securities to the top rating issued by nationally recognized credit rating organizations. The portfolio is expected to maintain a minimum weighted average credit quality of either "A" or better using either Standard and Poor's or Moody's credit ratings. The following table summarizes the fair value by investment type and maturities of investments held by the pension trust funds at June 30, 2007 (expressed in thousands):

Investments type	Less than 1 year	1 – 5 years	6 – 10 years	More than 10 years	No stated maturity date	Total
Non-U.S. equity securities	\$ —	—	—	—	1,254,122	1,254,122
U.S. equity securities	—	—	—	—	2,725,709	2,725,709
U.S. government and agencies securities	113,738	47,793	50,068	191,468	—	403,067
U.S. corporate debt securities	692	66,599	64,638	103,823	—	235,752
Limited partnership/private equity	—	—	—	—	94,470	94,470
Other	—	—	—	—	15,606	15,606
Total	<u>\$ 114,430</u>	<u>114,392</u>	<u>114,706</u>	<u>295,291</u>	<u>4,089,907</u>	<u>4,728,726</u>

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Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table summarizes the credit quality ratings for investments held by the pension trust funds at June 30, 2007 (expressed in thousands):

<b>Investments type</b>	<b>Fair value</b>	<b>AAA to A</b>	<b>BBB+</b>	<b>Not rated</b>
Non-U.S. equity securities	\$ 1,254,122	—	—	1,254,122
U.S. equity securities	2,725,709	—	—	2,725,709
U.S. government and agencies securities	403,067	398,403	469	4,195
U.S. corporate debt securities	235,752	142,397	88,051	5,304
Limited partnership/private equity	94,470	—	—	94,470
Other	15,606	—	—	15,606
Total	\$ <u>4,728,726</u>	<u>540,800</u>	<u>88,520</u>	<u>4,099,406</u>

At June 30, 2007, securities investments amounting to \$4.7 billion were registered in the name of the pension trust funds and were held in the possession of the pension's trust funds custodian banks.

The investment in non-U.S. stocks is expected to achieve long-term, aggressive capital appreciation by investing in Core EAFE (Europe Australasia and the Far East) securities. The portfolio is expected to be broadly diversified with respect to exposures to countries, economic sectors, industries, and individual stock. No single issue is expected to exceed 5% (at market) of the portfolio.

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Investments exposed to foreign currency risk as of June 30, 2007 are as follows (expressed in thousands):

Investment type	Currency	Fair value at U.S. dollar currency
Equity securities	Euro	\$ 360,279
Equity securities	Japanese yen	270,355
Equity securities	British pound sterling	260,959
Equity securities	Swiss franc	87,106
Equity securities	Swedish krone	51,919
Equity securities	Australian dollar	40,065
Depository receipts	Commingled	37,285
Equity securities	Hong Kong dollar	23,338
Equity securities	Norwegian krone	21,479
Equity securities	Singapore dollar	13,926
Equity securities	Danish krone	12,365
Equity securities	Brazilian real	11,071
Equity securities	Chinese yuan	10,325
Equity securities	Indian rupees	8,719
Equity securities	Canadian dollar	7,151
Mutual funds	British pound sterling	6,844
Equity securities	Mexican pesos	6,023
Equity securities	Russian rubles	5,679
Preferred stock	Swiss franc	3,517
Equity securities	Polish zlotys	3,499
Equity securities	South Korean won	3,212
Equity securities	Indonesian rupiahs	2,753
Equity securities	Danish kroner	2,353
Equity securities	Turkey lira	1,262
Equity securities	South African rand	803
Equity securities	Taiwan new dollars	803
Equity securities	Malaysian ringgits	459
Equity securities	Colombian pesos	287
Equity securities	Cyprus pounds	229
Equity securities	New Zealand dollar	57
		<u>\$ 1,254,122</u>

### (7) Securities Lending Transactions

During the year, the pension trust funds, included within the fiduciary funds, SIFC and AACA, two discretely presented component units, entered into securities lending transactions. These transactions are explained below:

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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### Pension Trust Funds

The Retirements System participates in a security lending program whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, government securities, and irrevocable bank letters of credit equal to approximately 102% of the market value of the domestic securities on loan and 105% of the market value of the international securities on loan, with a simultaneous agreement to return the collateral for the same securities in the future. Collateral is marked to market daily, and the agent places a request for additional collateral from brokers if needed. The custodian bank is the agent for the securities lending program.

Securities lending obligations for which collateral was received as of June 30, 2007 consist of the following (expressed in thousands):

<u>Securities lent</u>	<u>Fair value of underlying securities</u>
U.S. corporate debt securities	\$ 17,370
U.S. government securities	25,145
U.S. equity securities	198,844
Non-U.S. equity securities	57,915
	<u>\$ 299,274</u>

The collateral received amounted to approximately \$309 million. The collateral securities cannot be pledged or sold unless the borrower defaults; therefore, these transactions are not reported as assets and liabilities in the statements of fiduciary net assets. Collateral received was invested as follows (expressed in thousands):

<u>Collateral</u>	<u>Fair value</u>
Commercial paper	\$ 114,327
Certificate of deposit	65,015
Corporate	44,529
Bank note	4,665
TD	10,339
Repo	7,718
ABCP	1,611
CP	2,236
Reverse repurchase agreement U.S. agency delivered	6,577
Reverse repurchase agreement U.S. mortgage-backed triparty	52,000
	<u>\$ 309,017</u>

The relationship between the investment maturities and the Retirement Systems' loans cannot be determined.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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At year-end, the Retirement Systems have no credit risk exposure to borrowers because the amounts that the Retirement Systems owe the borrowers exceed the amounts the borrowers owe to the Retirement Systems. The Retirement Systems' rights to collateral are defined in the contractual agreements. The borrower's creditworthiness is also proactively reviewed by the lending agent.

#### *Component Units*

##### **SIFC**

The Commonwealth statutes and the SIFC's board of directors' policies permit SIFC to use its investments to enter into securities lending transactions. The SIFC's securities custodian, as agent of SIFC, manages the securities lending program and receives cash, securities, or irrevocable bank letters of credit as collateral. The collateral securities cannot be pledged or sold by SIFC unless the borrower defaults. The collateral requirement is equal to 102% for securities issued in the United States of America and 105% for securities issued outside of the United States of America of the fair value of the securities lent. Additional collateral has to be provided by the next business day if its value falls to less than 100% of the fair value of the securities lent. At year-end, SIFC has no credit risk exposure to borrowers because the amounts SIFC owes the borrowers exceed the amounts the borrowers owe SIFC. Contracts with the lending agents require them to indemnify SIFC if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay SIFC for income distributions by the securities' issuers while the securities are on loan.

All security loans can be terminated on demand by either SIFC or the borrower, although the average term of the loans is two weeks. In lending securities, the term to maturity of the securities loans is matched with the term to maturity of the investment of the cash collateral. Such matching existed at year-end. Securities lending obligations for which cash was received as collateral as of June 30, 2007 consist of the following (expressed in thousands):

<b>Securities lent</b>	<b>Fair value of underlying securities</b>
Equity securities	\$ 38,869
U.S. government, agencies, instrumentalities obligations	90,760
Corporate bonds and notes	17,650
	<u>\$ 147,279</u>

Cash collateral received amounted to \$149 million and it was invested in repurchase agreements. These secured lending activities are included in the accompanying statement of net assets, since cash was received as collateral but reinvested as explained above.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

In addition, SIFC had the following securities lending obligations collateralized by securities as of June 30, 2007 (expressed in thousands):

<b>Securities lent</b>	<b>Fair value of underlying securities</b>	<b>Securities collateral received</b>
U.S. government, agencies, instrumentalities obligations	\$ 67,032	72,325

These securities lending transactions are collateralized by securities that cannot be pledged or sold unless the borrower defaults; therefore, they are not reported as assets and liabilities in the accompanying balance sheets.

### AACA

AACA lends securities to broker/dealers and other entities (borrowers) for collateral that will be returned in the future for the same securities. The custodial bank manages the securities lending program and receives cash, government securities, and letters of credit as collateral. The program provides for an initial minimum collateralization of 102% of the market value of the securities lent plus accrued income. Additional collateral has to be provided by the close of the next business day if its value falls to less than 100%. The contract with the custodial bank requires that should a collateral deficiency occur beyond the custodian's responsibilities, the deficiency should be allocated pro rata among all client lenders within the program.

Either the custodian bank or the borrower can terminate all security loans at any time. Cash collateral is invested in the program's agent short-term investment pools, which at fiscal year-end had a weighted average maturity of approximately 30 days. The relationship between securities of the investment pool and AACA loans cannot be determined.

The following represents the balances relating to the securities lending transactions as of June 30, 2007 (expressed in thousands):

<b>Securities lent</b>	<b>Fair value of underlying securities</b>	<b>Cash collateral received</b>	<b>Noncash collateral received</b>
U.S. Treasury bills, bonds, and notes	\$ 29,478	28,618	1,400
Common stocks and preferred stocks	27,302	27,380	612
Corporate bonds	800	823	—
U.S. agencies	2,121	2,160	—
<b>Total</b>	<b>\$ 59,701</b>	<b>58,981</b>	<b>2,012</b>

Secured lending transactions where cash collateral was received and reinvested are presented as assets and liabilities in the accompanying statement of net assets. Securities lending transactions collateralized by noncash collateral cannot be pledged or sold unless the borrower defaults are not reported as assets or

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

liabilities in the statement of net assets. At year-end, AACA has no credit risk exposure to borrowers because the amounts AACA owes the borrowers exceed the amounts the borrowers owe AACA.

#### **(8) Investments in Limited Partnerships**

Pursuant to the Statement of Investment Guidelines for the Government of Puerto Rico, the pension trust funds and a component unit invested approximately \$17.3 million in limited partnerships during the year ended June 30, 2007. The investments were as follows:

- During fiscal year 2007, there were \$403,873 contributions made during fiscal year 2007 in Guayacán Funds of Funds, L.P., a Delaware limited partnership, organized by Grupo Guayacán, Inc. as general partner, which has total commitments of \$55.5 million (of which \$45 million are from pension trust funds and the remaining balances from private corporate investors). This fund invests in the United States of America and international private equity partnerships that in turn invest in private companies.
- During fiscal year 2007, \$7.5 million was invested in Guayacán Fund of Funds II, L.P., a Delaware limited partnership, organized by Grupo Guayacán, Inc. as general partner, that has total commitments of \$62 million (of which \$50 million are from the pension trust funds and the remaining balances from private corporate investors). The fund invests in a broad range of U.S. and international private equity investment partnerships that, in turn, will make equity and equity-related investments primarily in private businesses.
- During fiscal year 2007, there were no contributions in Guayacán Private Equity Fund, L.P., a Delaware limited partnership, organized by Advent-Morro Equity Partners, Inc. as general partner, that has total commitments of \$42 million (of which \$10 million are from the pension trust funds, \$22.5 million are from component units and the remaining balance from the private corporate investors in Puerto Rico). This fund invests in Puerto Rico private equity.
- During fiscal year 2007, \$4 million was invested in Guayacán Private Equity Fund, L.P. II, a Delaware limited partnership, organized by Advent/Morro Partners as general partner, has total commitments of \$54 million (of which \$35 million are from components units, \$15 million are from pension trust funds and the remaining balance from the private corporate investors in Puerto Rico). This fund invests in Puerto Rico private equity.
- During fiscal year 2007, \$251,000 was invested in Invesco Venture Partnership Fund III, L.P., a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as general partner in which the pension trust fund has a total commitment of \$5.5 million. The partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily U.S. and international funds that focus on both early- and later-stage venture capital investments.
- During fiscal year 2007, there were no contributions to Invesco Non-U.S. Partnership Fund III, L.P., a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as general partner, in which the pension trust fund has a total commitment of \$4.5 million. The partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily investments focusing on non-U.S. buyouts, expansion capital, turnaround, mezzanine, and distressed investment partnership.
- During fiscal year 2007, \$354,000 was invested in Invesco U.S. Buyout & Expansion Capital Partnership Fund III, L.P., a Delaware limited partnership, organized by IPC Partnership Associates III,

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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LLC as general partner, in which the pension trust fund has a total commitment of \$3.7 million. The partnership was organized to invest in other collective funds investing in alternative assets, including primarily investments focusing on small, mid-size, and large domestic buyout transactions.

- During fiscal year 2007, \$534,000 was invested in Chase Capital Partners Private Equity Fund of Funds II, LTD, a limited partnership, organized by Chase as general partner, in which the pension trust fund has a total commitment of \$15 million. The fund's investment strategy is to capitalize on a globally diversified portfolio of private equity investments opportunities across various sectors, including buyouts, growth equity, venture capital and other special situations through partnership, investments, and direct investments.
- During fiscal year 2007, there were no additional contributions to Venture Capital Fund, Inc., a Puerto Rico Corporation, organized pursuant to Act No. 3 of October 6, 1987, as amended, known as the Puerto Rico Capital Investment Funds Act that is managed by Advent-Morro Equity Partners (Advent-Morro Equity Partners, Inc.) in which the pension trust fund has a total commitment of \$800,000. Advent-Morro is a Puerto Rico based private equity firm. The fund was created to make private equity investments in operating companies that are based, or are operating or a combination of both, in Puerto Rico. Since inception, the fund has invested in 25 companies some of which it continues to provide capital for their expansion.
- During fiscal year 2007, \$3.1 million was invested in GF Capital Private Equity Fund, L.P., a limited partnership, organized under the laws of the State of Delaware, in which the pension trust fund has a total commitment of \$25 million. The purpose of the partnership is to make private equity investments in a variety of industries including media and entertainment, branded consumer products, and software for media and telecommunications applications. The partnership initiatives are focused on companies capitalized at between \$20 million to \$400 million with a representation of buyouts, growth capital, and recapitalizations.
- During fiscal year 2007, \$1.1 million was invested in Chase Capital Partners Private Equity Fund of Funds Corporate Investors II, LTD a limited partnership, organized by Chase as general partner in which the pension trust fund has a total commitment of \$20 million. The fund's investment strategy is to capitalize on a globally diversified portfolio of private equity investment opportunities across various sectors including buyouts, growth equity, venture capital, and other special situations through partnership and direct investments.

The fair value of these investments at June 30, 2007 amounted to \$94.5 million and is presented within investments in the statement of fiduciary net assets. The fair values of these investments have been estimated by the corresponding general partner or fund manager of these partnerships and disclosed in its respective separate audited financial statements. The allocations of net gain and net loss to the limited partners are based on certain percentages, as established in the limited partnership agreements. The difference between the fair value of the investments and the total cumulative contributions is mostly due to distributions made.



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

As of June 30, 2007, the pension trust funds and discretely presented component units had capital commitments and contributions as follows (expressed in thousands):

<b>Guayacán Funds of Funds, L.P.</b>	<b><u>Public sector commitments</u></b>	<b><u>Fiscal year contributions</u></b>	<b><u>Cumulative contributions</u></b>
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	\$ 25,000	224	23,503
Puerto Rico System of Annuities and Pensions for Teachers	<u>20,000</u>	<u>180</u>	<u>18,803</u>
Subtotal	<u>45,000</u>	<u>404</u>	<u>42,306</u>
<b>Guayacán Funds of Funds II, L.P.</b>			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	\$ 25,000	3,772	23,411
Puerto Rico System of Annuities and Pensions for Teachers	<u>25,000</u>	<u>3,772</u>	<u>23,411</u>
Subtotal	<u>50,000</u>	<u>7,544</u>	<u>46,822</u>

# COMMONWEALTH OF PUERTO RICO

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<b>Guayacán Private Equity Fund, L.P.</b>	<b>Public sector commitments</b>	<b>Fiscal year contributions</b>	<b>Cumulative contributions</b>
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	5,000	—	4,407
Puerto Rico System of Annuities and Pensions for Teachers	5,000	—	4,407
Component unit:			
Economic Development Bank for Puerto Rico	20,000	—	17,625
UPR Employees Retirement System	2,500	—	2,203
Subtotal	32,500	—	28,642
<b>Guayacán Private Equity Fund, L.P. II</b>			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	15,000	1,200	1,200
Component unit:			
Economic Development Bank for Puerto Rico	20,000	1,600	1,600
State Insurance Fund Corporation	10,000	800	800
UPR Employees Retirement System	5,000	400	400
Subtotal	50,000	4,000	4,000
<b>Other Funds</b>			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	47,596	4,193	23,690
Puerto Rico System of Annuities and Pensions for Teachers	28,714	1,139	24,687
Subtotal	76,310	5,332	48,377
Total	\$ 253,810	17,280	170,147

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### (9) Receivables and Payables

Receivables in the governmental funds include approximately \$1.3 billion of accrued income, excise and sales and use taxes. Other receivables are \$704 million receivable from the federal government and \$11.8 million from the CRIM. In addition, the enterprise funds include \$58.9 million of unemployment, disability, and drivers' insurance premium receivable.

Payables in the governmental funds include approximately \$1.2 billion of trade accounts due to suppliers for purchase of merchandise and services rendered, \$312 million of tax refunds liability, and \$32 million of other payables. Also at June 30, 2007, excess of checks drawn over the pooled bank balance amounted to approximately \$809 million and is reported within accounts payable and accrued liabilities of the governmental activities.

In accordance with GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issue* (the TB), a receivable of \$37 million was recorded as other receivable in the government-wide financial statements for estimated shipments from January 1 to June 30, 2007, which will be applied to debt service upon collection. Additionally, the TB indicated that the Trust designated as the Tobacco Settlement Authority (TSA) should recognize a liability for the bonds payable and an expense (and liability if unpaid) in the same period in its stand-alone financial statements. The expense (and liability if unpaid) recognizes the contractual obligation to remit the proceeds of the bond sold. Since the Trust is reported as a blended component unit, the TB indicates these remittances should be reported as transfers into the fund receiving the proceeds and transfers out in the fund that accounts for the activities of the TSA. Since the Trust has no contractual obligation, under its enabling legislation or elsewhere, to remit all bond proceeds or assets related to the GSA to the settling government (the Commonwealth), the Trust has not recognized an expense and liability for unpaid proceeds from the bonds since it records the expense as amounts are disbursed as grants to its settling government (including its instrumentalities) or third parties.

### (10) Interfund and Intraentity Transactions

Interfund receivables and payables at June 30, 2007 are summarized as follows (expressed in thousands):

Receivable fund	Payable fund	Amount
Nonmajor governmental fund	General fund	\$ 178,011
Lotteries	General fund	53,175
General fund	Lotteries	61,446
		<u>\$ 292,632</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Transfers from (to) other funds for the year ended June 30, 2007 are summarized as follows (expressed in thousands):

<b>Transferee fund</b>	<b>Transferor fund</b>	<b>Amount</b>
General	Nonmajor governmental	\$ 335,789
General	Unemployment insurance	169,933
General	Lotteries	197,044
Nonmajor governmental	General	162,153
PBA capital projects	General	145,813
Debt service	General	82,386
General	The Children's Trust special revenue	71,627
Lotteries	General	16,863
Nonmajor enterprise	General	7,458
The Children's Trust special revenue	General	243
General	Nonmajor enterprise	87
		<u>\$ 1,189,396</u>

The principal purposes of the interfund transfers are to (expressed in thousands):

1. Distribute the increase in net assets of the lotteries fund for the use of the general fund, as required by the lotteries enabling legislation (\$197,044).
2. Unemployment insurance fund's distribution of surplus cash belonging to the general fund for the payment of administrative expenses (\$169,933).
3. Recognize as transfers the rental payments made by the Commonwealth's agencies on properties leased by PBA, a blended component unit of the Commonwealth (\$162,153) to the nonmajor funds of PBA and \$145,813 to the PBA capital project fund.
4. Make funds available for debt service payments in the debt service fund (\$82,386).
5. Transfer from The Children's Trust special revenue fund to the general fund in order to provide financial assistance to carry out project aimed at promoting the well-being of children and youth of Puerto Rico (\$71,627)
6. Transfer from the general fund to Additional Lottery to cover prizes settlement pursuant Act No. 171 of July 28, 2004 (\$16,863).
7. Transfer from (a non major governmental fund, mainly the capital project fund) for repayment of the general fund's lines of credit, pursuant to such line of credit agreement (\$335,789).
8. To provide local matching funds from the general fund related to the federal capital grants of the Puerto Rico Water Pollution Revolving Fund and Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, two nonmajor enterprise funds of the Commonwealth (\$7,458).

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

9. Transfer of \$243 from the tobacco settlement asset-backed bonds debt service fund to The Children's Trust special revenue fund in order to provide funds for operating expenses.
10. Transfer of \$87 from the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund to the general fund attributed to a reimbursement representing an excess matching contribution corresponding to previous years.

Interfund receivables and payables represent the pending settlements of the aforementioned transfers or transactions from prior years.

Due from (to) primary government and component units are as follows (expressed in thousands):

<u>Receivable entity/fund</u>	<u>Amount</u>	<u>Payable entity/fund</u>	<u>Amount</u>
Business-type activities	\$ 229,173	Puerto Rico Aqueduct and Sewer Authority	\$ 229,173
		Cardiovascular Center Corporation of Puerto Rico and the Caribbean	44,074
		Puerto Rico Medical Services Administration	43,070
		Puerto Rico Health Insurance Administration	27,600
		Puerto Rico Tourism Company	22,178
		Employment and Training Enterprises Corporation	7,108
Governmental activities	149,545	Governing Board of the 911 Service	5,515
	<u>\$ 378,718</u>		<u>\$ 378,718</u>
Puerto Rico Electric Power Authority	\$ 175,645	Governmental activities	\$ 495,610
Puerto Rico Health Insurance Administration	148,900		
University of Puerto Rico	95,853		
Puerto Rico Medical Services Administration	33,983		
Puerto Rico Industrial Development Company	23,403		
Puerto Rico Conservatory of Music	14,189		
Land Authority of Puerto Rico	3,637		
	<u>\$ 495,610</u>		<u>\$ 495,610</u>

The amount owed by PRASA of \$229 million represents construction loans granted by the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, nonmajor enterprise funds, to finance the construction of capital assets for PRASA.

## **COMMONWEALTH OF PUERTO RICO**

### **Notes to Basic Financial Statements**

**June 30, 2007**

The amount receivable by PREPA from the primary government includes approximately \$43 million representing an agreement with the Commonwealth by which the Commonwealth will pay the outstanding fuel adjustment subsidy and certain other accumulated debt. The amount owed by the Commonwealth is presented within notes payable in the statement of net assets of the governmental activities.

The amount receivable by the UPR from the primary government includes a resolution approved by the Legislature of the Commonwealth to pay \$94.7 million to the UPR on behalf of the Department of Health of the Commonwealth over eight years, including the financing of additional debts of approximately \$71.2 million. The related outstanding balance of \$63.8 million is presented by the Commonwealth within notes payable in the statement of net assets of the governmental activities.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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Due from (to) component units are as follows (expressed in thousands):

Receivable entity/fund	Amount	Payable entity/fund	Amount
Puerto Rico Electric Power Authority	\$ 31,909	Puerto Rico Medical Services Administration	\$ 44,054
University of Puerto Rico	19,337	Cardiovascular Center Corporation of Puerto Rico and the Caribbean	7,192
State Insurance Fund Corporation	3,500	Puerto Rico Solid Waste Authority	3,500
Puerto Rico Land Administration	3,916	Puerto Rico Industrial Development Company	3,916
Farm Insurance Corporation of Puerto Rico	13,257	Agricultural Services and Development Administration	16,180
Land Authority of Puerto Rico	9,354	Farm Insurance Corporation of Puerto Rico	6,431
	<u>81,273</u>	Sub total	<u>81,273</u>
Governmental Development Bank for Puerto Rico	1,475,582	Special Communities Perpetual Trust	385,152
		Puerto Rico Sales Tax Financing Corporation Authority	303,024
		Puerto Rico Aqueduct and Sewer Authority	155,221
		Agricultural Services and Development Administration	139,524
		Puerto Rico Industrial Development Company	127,578
		Puerto Rico Solid Waste Authority	81,075
		Puerto Rico Infrastructure Financing Authority	59,497
		Puerto Rico Electric Power Authority	53,290
		University of Puerto Rico	49,489
		Land Authority of Puerto Rico	37,271
		Institute of Puerto Rican Culture	36,741
		Economic Development Bank for Puerto Rico	22,756
		National Parks Company of Puerto Rico	11,876
		Puerto Rico Ports Authority	3,830
		Puerto Rico Convention Center District	2,750
			<u>1,469,074</u>
	<u>\$ 1,556,855</u>		<u>\$ 1,550,347</u>

The difference amounting to \$6.5 million between due from (to) component units resulted from the time lag between the dates that transactions are recorded by each discretely presented component unit and other reconciling items. The balance due to GDB amounting to approximately \$1.5 billion represents loans payable to GDB at June 30, 2007.

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## Notes to Basic Financial Statements

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The rest of the loans receivable reported by GDB consists of the following (expressed in thousands):

Primary government – governmental activities	\$ 3,422,137
Other governmental entities and municipalities	926,338
Private sector (net of \$10,206 presented within restricted assets)	407,498
Total loans receivable reported by GDB	<u>\$ 4,755,973</u>

The loans to the primary government are presented by the Commonwealth within notes payable in the statement of net assets.

Expenses of the primary government include approximately \$2.6 billion in capital and operational contributions made by the primary government to the component units comprise the following (expressed in thousands):

Puerto Rico Health Insurance Administration	\$ 1,142,347
University of Puerto Rico	861,503
Puerto Rico Infrastructure Financing Authority	98,320
Government Development Bank for Puerto Rico	65,850
Puerto Rico Aqueduct and Sewer Authority	700
Nonmajor component units	445,345
Total contributions made by primary government to component units	<u>\$ 2,614,065</u>

### (11) Restricted Assets

Restricted assets of the primary government included in the basic financial statements at June 30, 2007 consist of cash, investments, and other assets to be used for the following purposes (expressed in thousands):

Debt service and sinking fund	\$ 1,490,524
Public Housing Administration – funds received from HUD	450,112
Assets held in trust for repayment of QZAB	73,051
Construction and betterment funds	50,036
Investment held for disability insurance benefits	35,606
Construction of governmental facilities	29,754
Assets held for development of urban forest	19,200
Emergency fund	574
Other	33,605
	<u>\$ 2,182,462</u>



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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Liabilities of the primary government payable from restricted assets consist of the following (expressed in thousands):

Governmental activities:

Qualified Zone Academic Bonds	\$	184,124
Tax revenue anticipation notes		881,484
Deferred revenue		108,970
Interest payable		564,623

Liabilities payable from restricted assets – governmental activities	\$	<u>1,739,201</u>
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Business-type activities:

Disability insurance benefit payable	\$	<u>851</u>
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Liabilities payable from restricted assets – business-type activities	\$	<u>851</u>
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Governmental activities restricted net assets:

Restricted for capital project	\$	11,601
Restricted for debt service		159,817
Other purpose		159,633

Total restricted net assets	\$	<u>331,051</u>
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Restricted assets of the component units included in the basic financial statements at June 30, 2007 are to be used for the following purposes (expressed in thousands):

Debt service and sinking fund requirements	\$	5,566,347
Construction and betterments funds		1,977,951
Collateral for underlying securities		716,800
Other uses		164,914
Educational fund		148,774
Malpractice insurance fund		73,461
Maintenance reserve fund		51,649
Industrial incentives		4,446
Escrow		145
Incentive to farmers		2
Total for components units	\$	<u>8,704,489</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### (12) Capital Assets

Capital assets activity for the year ended June 30, 2007 is as follows (expressed in thousands):

#### *Primary Government*

	<u>Beginning balance (as restated)</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 848,443	9,108	13,018	844,533
Construction in progress	1,396,503	401,727	363,252	1,434,978
Total capital assets, not being depreciated	<u>2,244,946</u>	<u>410,835</u>	<u>376,270</u>	<u>2,279,511</u>
Capital assets, being depreciated:				
Buildings and building improvements	6,595,302	362,624	32,553	6,925,373
Equipment furniture, fixtures and vehicles	390,631	68,329	8,850	450,110
Infrastructure	441,500	—	—	441,500
Total capital assets, being depreciated	<u>7,427,433</u>	<u>430,953</u>	<u>41,403</u>	<u>7,816,983</u>
Less accumulated depreciation for:				
Buildings and building improvements	2,200,152	190,207	18,554	2,371,805
Equipment furniture, fixtures and vehicles	190,418	36,654	3,012	224,060
Infrastructure	83,951	8,830	—	92,781
Total accumulated depreciation	<u>2,474,521</u>	<u>235,691</u>	<u>21,566</u>	<u>2,688,646</u>
Total capital assets, being depreciated, net	<u>4,952,912</u>	<u>195,262</u>	<u>19,837</u>	<u>5,128,337</u>
Governmental activities capital assets, net	<u>\$ 7,197,858</u>	<u>606,097</u>	<u>396,107</u>	<u>7,407,848</u>
Business-type activities:				
Total capital assets, being depreciated – equipment	\$ 5,043	—	233	4,810
Less accumulated depreciation of equipment	<u>4,035</u>	<u>334</u>	<u>233</u>	<u>4,136</u>
Total business-type activities capital assets, being depreciated, net	<u>\$ 1,008</u>	<u>(334)</u>	<u>—</u>	<u>674</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Depreciation expense was charged to functions/programs of the primary government for the year ended June 30, 2007 as follows (expressed in thousands):

Governmental activities:	
General government	\$ 76,697
Public safety	24,112
Health	6,297
Public housing and welfare	83,684
Education	30,374
Economic development	14,527
Total depreciation expense – governmental activities	\$ 235,691
Total depreciation business-type activities – lotteries	\$ 334

The net book value of capital assets of the primary government as of beginning of the year was increased to reflect the noncapitalization of capital assets payable by approximately \$14.7 million.

The Commonwealth follows the provision of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, an amendment to GASB Statement No. 34. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries. The Commonwealth recognized an impairment loss of \$3.4 million in the statement of activities, related to the reduction in use of educational facilities.

General infrastructure assets include \$417 million representing the estimated cost of assets transferred to the Department of Natural and Environmental Resources (DNER) of the Commonwealth in 1997 upon completion of the Cerrillos Dam and Reservoir and the Portugues-River and Bucana-River Projects by the U.S. Army Corps of Engineers. These infrastructure assets are reported within governmental activities and include dams, intake facilities, and similar items built for flood control, water supply, and recreational purposes. The Commonwealth also recorded a payable due to the U.S. Army Corps of Engineers, amounting to \$205 million, for its estimated allocated share of the construction costs associated with these projects, including accrued interest of \$5 million. The final debt agreement between DNER and the U.S. Army Corps of Engineers has not been finalized, and therefore, terms and conditions could differ from those estimated. The depreciation is computed using the straight-line method over an estimated useful life of 50 years from the transfer date of the property. The related debt is expected to be payable on an annual basis over a 50-year period. However, the debt has been presented as a long-term payable after one year in the accompanying statement of net assets since the commencement date of repayment has not yet been determined.

On August 17, 2001, the Legislature of the Commonwealth approved Act No. 120, which requires the conditional transfer of the ownership of certain real properties under the name of the Department of Recreation and Sports (DRS) of the Commonwealth to the municipalities of the Commonwealth. The land and the facilities were transferred at no cost to the municipalities. During fiscal year ended June 30, 2007, land, building, and building improvements with a total carrying amount of \$29 million were transferred to several municipalities and recorded as an expense in the accompanying statement of activities.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### *Discretely Presented Component Units*

	<b>Beginning balance (as restated)</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending balance</b>
Capital assets, not being depreciated:				
Land	\$ 2,539,366	135,565	46,119	2,628,812
Art works	8,603	4	—	8,607
Construction in progress	6,238,211	1,858,801	1,691,305	6,405,707
Total capital assets, not being depreciated	8,786,180	1,994,370	1,737,424	9,043,126
Capital assets, being depreciated:				
Buildings and buildings improvements	8,958,948	397,789	240,311	9,116,426
Equipment, furniture, fixtures and vehicles	1,308,083	383,340	31,386	1,660,037
Infrastructure	22,576,754	1,199,151	3,004	23,772,901
Total capital assets, being depreciated	32,843,785	1,980,280	274,701	34,549,364
Less accumulated depreciation for:				
Buildings and buildings improvements	5,047,766	369,497	207,611	5,209,652
Equipment, furniture, fixtures and vehicles	769,522	132,778	21,578	880,722
Infrastructure	9,141,492	654,946	2,420	9,794,018
Total accumulated depreciation	14,958,780	1,157,221	231,609	15,884,392
Total capital assets, being depreciated, net	17,885,005	823,059	43,092	18,664,972
Capital assets, net	\$ 26,671,185	2,817,429	1,780,516	27,708,098

The restatements in the beginning balance of capital assets by approximately \$60.3 million is related to several component units sustaining restatements included in note 4.

### **(13) Tax Revenue Anticipation Notes Payable**

Tax revenue anticipation notes (TRANS) reported in the general fund were issued on October 26, 2006 at interest rates of 4.5% and were paid on July 30, 2007. The TRANS amounted to \$881 million at June 30, 2007 plus accrued interest of approximately \$27 million. The proceeds of the TRANS were used to cover temporary cash deficiencies resulting from the timing differences between tax collections and the payments of current expenditures.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### (14) Short and Long-Term Obligations

#### Primary Government

#### (a) Summary of Short and Long-Term Obligations

Short and long-term obligations at June 30, 2007 and changes for the year then ended are as follows (expressed in thousands):

	Balance at June 30, 2006	Debt issued	Capitalized interest	Debt paid	Original issue (discounts) premiums	Other net increases (decreases)	Balance at June 30, 2007	Due within one year
<b>Governmental activities:</b>								
General obligation and revenue bonds	\$ 12,195,083	1,065,390	31,247	(303,360)	21,233	24,809	13,034,402	318,380
Commonwealth appropriation bonds	2,642,194	—	1,551	(84,189)	—	3,836	2,563,392	99,971
Qualified Zone Academy Bonds	184,124	—	—	—	—	—	184,124	—
<b>Notes payable to component units:</b>								
GDB (short term)	526,044	100,233	—	(327,202)	—	—	299,075	299,075
GDB	3,179,083	433,231	—	(489,252)	—	—	3,123,062	413,254
Other	114,651	—	—	(7,785)	—	—	106,866	36,009
<b>Total bonds and notes payable</b>	<b>18,841,179</b>	<b>1,598,854</b>	<b>32,798</b>	<b>(1,211,788)</b>	<b>21,233</b>	<b>28,645</b>	<b>19,310,921</b>	<b>1,166,689</b>
Compensated absences	1,683,953	—	—	(962,323)	—	1,072,485	1,794,115	1,065,805
Net pension obligation	4,740,806	—	—	—	—	355,518	5,096,324	—
Obligation under capital lease arrangements	144,501	2,975	—	(4,663)	—	(1,002)	141,811	4,808
<b>Other liabilities:</b>								
Employees' Christmas bonus	102,562	—	—	(175,821)	—	173,333	100,074	100,074
Liability for federal cost disallowances	53,047	—	—	—	—	(2,888)	50,159	50,159
Liability for legal claims and judgments	801,167	—	—	(26,076)	—	175,185	950,276	26,000
Other	205,000	—	—	—	—	—	205,000	—
<b>Total governmental activities</b>	<b>26,572,215</b>	<b>1,601,829</b>	<b>32,798</b>	<b>(2,380,671)</b>	<b>21,233</b>	<b>1,801,276</b>	<b>27,648,680</b>	<b>2,413,535</b>
<b>Business-type activities:</b>								
Compensated absences	7,365	—	—	(3,857)	—	2,489	5,997	3,945
Obligation for unpaid lottery prizes	303,703	—	—	(37,488)	—	26,075	292,290	55,377
Claims liability for insurance benefits	70,973	—	—	(70,973)	—	57,915	57,915	57,915
<b>Total business-type activities</b>	<b>382,041</b>	<b>—</b>	<b>—</b>	<b>(112,318)</b>	<b>—</b>	<b>86,479</b>	<b>356,202</b>	<b>117,237</b>
<b>Total governmental and business-type</b>	<b>\$ 26,954,256</b>	<b>1,601,829</b>	<b>32,798</b>	<b>(2,492,989)</b>	<b>21,233</b>	<b>1,887,755</b>	<b>28,004,882</b>	<b>2,530,772</b>

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

The balances of long-term debt issued included within other financing sources and debt service principal expenditures as reported in the statement of revenue, expenditures, and changes in fund balances – governmental funds do not agree with amounts reported as debt issued and paid in the above table primarily because the above table includes debt issued and paid on short-term obligations, which amounted to approximately \$100.2 million and \$327.2 million, respectively. The receipt and payment of short-term obligations is reported as a balance sheet transaction in the fund financial statements.

The other net increases in bonds and notes payable consist of deferred losses on refunding, net of amortization, and net amortization of premiums and discounts on bonds. These adjustments did not require any source or use of cash.

Compensated absences, net pension obligation, obligation for unpaid lottery awards, liability for insurance benefits, and other long-term liabilities reflect other net increases (decreases) resulting from adjustments and changes to agree these obligations to their new estimated balances at June 30, 2007.

#### **(b) Debt Limitation**

The Constitution of the Commonwealth authorizes the contracting of debts as determined by the Legislature. Nevertheless, the Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit, and taxing power of the Commonwealth are not to be issued if the amounts of the principal of, and interest on, such bonds and notes and on all such bonds and notes issued thereafter, which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenue raised under the provisions of Commonwealth legislation and conveyed into the Treasury (hereinafter internal revenue) in the two fiscal years preceding the then current fiscal year. Section 2, Article VI of the Constitution does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. Internal revenue consists principally of income taxes and excise taxes. Certain revenue, such as federal excise taxes on offshore shipments of alcoholic beverages, tobacco products, and customs duties, which are collected by the U.S. government and returned to the Commonwealth, motor vehicle fuel taxes and license fees, which are allocated to the PRHTA, a discrete component unit, and a portion of the sales and use tax allocated to service the bonds issued by COFINA are not included as revenue for the purpose of calculating the debt limit, although they may be available for the payment of debt service. At June 30, 2007, the Commonwealth is in compliance with the debt limitation requirement.

#### **(c) Bonds Payable**

The Constitution of the Commonwealth provides that public debt will constitute a first claim on the available revenue of the Commonwealth. Public debt includes general obligations and notes of the Commonwealth and any payment required to be made by the Commonwealth under its guarantees of bonds issued by blended or discretely presented component units. The good faith, credit, and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal and interest of the general obligation bonds.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Act No. 83 of August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. The levy is made by CRIM, a municipal corporation, not a component unit of the Commonwealth. CRIM is required to remit the 1.03% of property tax collected to the Commonwealth to be used by the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth. During the year ended June 30, 2007, the total revenue and receivable reported by the Commonwealth amounted to approximately \$120 million and \$11.8 million, respectively, which are included in the debt service fund.

For financial reporting purposes, the outstanding amount of bonds represents the total principal to be repaid, net of unamortized premiums, discount, and deferred refunding losses; for capital appreciation bonds, it represents total principal and accreted interest to be repaid.

Bonds payable outstanding at June 30, 2007 are as follows (expressed in thousands):

	<u>General obligation</u>	<u>Revenue bonds</u>	<u>Total</u>
Term bonds payable through 2036; interest payable semiannually at rates varying from 3% to 8%.	\$ 3,293,025	1,588,655	4,881,680
Serial bonds payable through 2024; interest payable semiannually at rates varying from 3.75% to 7.50%.	4,519,080	1,054,740	5,573,820
Capital appreciation bonds payable through 2031; no interest rate, yield ranging from 4.42% to 7.80%. Net of accreted discount of \$168 million.	239,160	143,987	383,147
The Children's Trust Fund tobacco settlement asset-backed bonds payable through 2026; interest payable annually at rates varying from 4.625% to 6.000%.	—	1,234,904	1,234,904
Capital Fund Program Bonds, maturing in various dates payable through 2024; interest payable at rates varying from 2% to 5%.	—	619,105	619,105
Bond payment obligation payable through 2010; interest payable at rates varying from 1.5% to 5.5%.	125,910	—	125,910
Balance carried forward	\$ <u>8,177,175</u>	<u>4,641,391</u>	<u>12,818,566</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

	<u>General obligation</u>	<u>Revenue bonds</u>	<u>Total</u>
Balance brought forward	\$ 8,177,175	4,641,391	12,818,566
Yield curve bonds payable from 2009 through 2011; no interest rate, yield of 8.914%.	15,000	—	15,000
Yield retail bonds payable from 2009 through 2011; interest payable at rates varying from 2.875% to 5.000%.	21,000	—	21,000
Tax-exempt components maturing through 2007 and 2008; interest payable at rates ranging from 5.5% to 5.6%.	—	72,160	72,160
Inverse rate bonds payable from 2009 through 2011; interest payable at a rate of 6%.	15,000	—	15,000
Insured bonds payable from 2014 through 2018; interest payable at a rate of 5%.	64,360	—	64,360
Total	8,292,535	4,713,551	13,006,086
Unamortized premium, net	222,319	17,836	240,155
Deferred charges arising from debt refunding	(66,284)	(145,786)	(212,070)
Savings bonds	231	—	231
Total bonds payable	<u>\$ 8,448,801</u>	<u>4,585,601</u>	<u>13,034,402</u>



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

During the year ended June 30, 2007, the following changes occurred in the bonds payable (expressed in thousands):

	<b>Outstanding at June 30, 2006</b>	<b>Issued</b>	<b>Premiums/ discount (redemptions)</b>	<b>Outstanding at June 30, 2007</b>
Term bonds	\$ 4,406,850	517,125	(42,295)	4,881,680
Serial bonds	5,189,555	548,265	(164,000)	5,573,820
Capital appreciation bonds	419,634	—	(36,487)	383,147
The Children's Trust Fund tobacco settlement				
asset-backed bonds	1,239,015	—	(4,111)	1,234,904
Capital Fund Program Bonds	641,325	—	(22,220)	619,105
Bond payment obligations	125,910	—	—	125,910
Yield curve bonds	15,000	—	—	15,000
Yield retail bonds	24,000	—	(3,000)	21,000
Tax-exempt components	72,160	—	—	72,160
Inverse rate bonds	79,360	—	—	79,360
Subtotal	12,212,809	1,065,390	(272,113)	13,006,086
Unamortized premium	243,449	21,233	(24,527)	240,155
Deferred charges arising from debt refunding	(261,406)	—	49,336	(212,070)
Savings bonds	231	—	—	231
Total	<u>\$ 12,195,083</u>	<u>1,086,623</u>	<u>(247,304)</u>	<u>13,034,402</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Maturities of general obligations and of revenue bonds payable, including accrued interest of capital appreciation bonds, are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2008	\$ 318,380	611,882	930,262
2009	326,531	652,449	978,980
2010	384,080	606,611	990,691
2011	403,700	585,890	989,590
2012	415,544	578,730	994,274
2013 – 2017	2,256,133	2,584,324	4,840,457
2018 – 2022	2,725,407	1,977,416	4,702,823
2023 – 2027	2,313,699	1,330,936	3,644,635
2028 – 2032	2,103,071	812,700	2,915,771
2033 – 2037	1,303,661	292,228	1,595,889
2038 – 2042	256,362	81,782	338,144
2043 – 2047	37,164	4,578	41,742
Total	12,843,732	\$ 10,119,526	22,963,258
Plus accreted discount	162,585		
Plus unamortized premium	240,155		
Less deferred charges arising from debt refunding	(212,070)		
Total	\$ 13,034,402		

### (d) *Commonwealth Appropriation Bonds*

Over the years, GDB, as fiscal agent and bank for the Commonwealth, had extended lines of credit, advances, and loans to several agencies and component units in order to finance their capital improvement projects and to cover their operational deficits at the time. At different points in time, these loans were refunded through the issuance of Commonwealth appropriation bonds issued by the Puerto Rico Public Finance Corporation (PFC), a blended component unit of GDB. PFC is the financing arm of GDB, which serves only as a conduit for the issuance of the bonds.

During June 2004, PFC advance refunded through the PFC 2004 Series A and B and PFC 2003 Series A through C Refunding Commonwealth Appropriation Bonds, a portion of certain of its outstanding Commonwealth Appropriation Bonds issued in prior years (except for the Health Facilities and Services Administration bonds described below, where no portion was refunded). The Commonwealth recognized a mirror effect of this advance refunding by PFC in its own debt in proportion to the portion of the Commonwealth's notes included in the PFC refunding. As a result, the Commonwealth considered defeased and, therefore, removed from the balance sheet the portion refunded of \$775.7 million. The repayment source for these bonds (both the refunding and unrefunded portions) consisted until June 30, 2006 of Commonwealth appropriations submitted for approval of the Legislature annually during the budget preparation process of the Commonwealth.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

During July 2006, the source for the 2007 debt service of these appropriation bonds came from PFC instead (not from legislative appropriations), through an advance of approximately \$303 million. PFC will get its advance repaid by COFINA, a discretely presented component unit created in 2007 with the capacity to issue bonds to repay or refinance the advance from PFC, the appropriation bonds, the Qualified Zone Academic Bonds (QZAB) bonds and other debt obligations to GDB, collectively referred as the extra-constitutional debt. The COFINA debt in turn will be serviced with the revenues generated from the collection of the first 1% of the sales and use tax, which came in effect on November 15, 2006 (note 3(c)).

The outstanding balance of the Commonwealth appropriation bonds (both the refunding and unrefunded portion combined) comprises the following obligations (expressed in thousands):

Act No. 164 restructuring	\$ 1,458,343
Health Facilities and Services Administration	410,701
Office for the Improvement of Public Schools of Puerto Rico	319,272
Puerto Rico Maritime Shipping Authority	280,157
Property tax settlement	<u>94,919</u>
Total Commonwealth appropriation bonds	<u>\$ 2,563,392</u>

On December 17, 2001, Act No. 164 was approved, which authorized certain government agencies and discretely presented component units to refund approximately \$2.4 billion of their outstanding obligations with GDB, for which no repayment source existed, over a period not exceeding 30 years, and to be repaid with annual Commonwealth appropriations not to exceed \$225 million. This refunding was done with Commonwealth appropriation bonds through several series issued by PFC during the period between December 2001 and June 2002.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Approximately \$1.5 billion of the aforementioned outstanding obligations belonged to the primary government, predominantly the Department of Health of the Commonwealth (health reform financing and other costs for approximately \$1.1 billion) and the Department of the Treasury of the Commonwealth (the fiscal year 2001 deficit financing of \$268 million and the obligation assumed for defective tax liens in the amount of approximately \$132 million). The new combined bonds balance of the Act No. 164 restructuring bears interest at rates ranging from 1.25% to 5.80%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2008	\$ 35,076	81,944	117,020
2009	37,031	79,997	117,028
2010	34,707	80,860	115,567
2011	35,799	77,198	112,997
2012	38,506	75,288	113,794
2013-2017	245,683	332,521	578,204
2015-2022	332,797	241,162	573,959
2023-2027	369,396	117,145	486,541
2028-2031	348,769	28,913	377,682
Total	1,477,764	\$ 1,115,028	2,592,792
Plus unamortized premium	21,611		
Less deferred charges arising from debt refunding	(41,032)		
Total	\$ 1,458,343		

As of July 1, 1999, approximately \$595 million (including unpaid interest) of a promissory note of the Health Facilities and Services Administration (HFSA) due to GDB was transferred to the Department of Health of the Commonwealth and restructured through Commonwealth appropriation bonds. The bonds bear interest at rates ranging between 5.90% and 6.20%. Principal and interest on the bonds are payable solely from legislative appropriations to be made pursuant to Act No. 223 of August 9, 1998. The act provides that OMB shall include in the annual budget of the Commonwealth an amount equal to \$56.5 million for the fiscal year 1998-99, and for the next succeeding 15 fiscal years the amount necessary to pay the principal of and interest on the bonds, up to a maximum annual amount of \$57.7 million. As of June 30, 2007, approximately \$411 million was still outstanding.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2008	\$ 39,600	18,074	57,674
2009	42,125	15,555	57,680
2010	44,865	12,821	57,686
2011	25,018	32,714	57,732
2012	31,200	26,496	57,696
2013 – 2017	208,915	76,540	285,455
2018	18,978	38,732	57,710
Total	<u>\$ 410,701</u>	<u>220,932</u>	<u>631,633</u>

Previous public schools infrastructure improvement loans provided additional funds for major repairs and improvements to the public schools in Puerto Rico. This activity is administered by the Office for the Improvement of the Public Schools of Puerto Rico (OIPS), included as part of the general fund of the primary government. These loans were refunded originally through the issuance of Commonwealth appropriation bonds pursuant to Act No. 85 of June 13, 1998 (Act 85). The new combined bonds bear interest at rates ranging from 5.00% to 5.85%. As of June 30, 2007, approximately \$319 million was outstanding.

Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2008	\$ 9,945	17,648	27,593
2009	10,465	17,125	27,590
2010	10,990	16,602	27,592
2011	11,580	16,011	27,591
2012	12,200	15,555	27,755
2013 – 2017	77,675	58,674	136,349
2018 – 2022	87,950	37,807	125,757
2023 – 2026	105,880	11,816	117,696
Total	326,685	<u>\$ 191,238</u>	<u>517,923</u>
Plus unamortized premium	5,941		
Less deferred charges arising from debt refunding	<u>(13,354)</u>		
Total	<u>\$ 319,272</u>		

A promissory note payable owed by PRMSA to GDB was assumed by the Commonwealth in connection with the sale of the maritime operations of PRMSA. Commonwealth appropriation bonds were issued to refund this liability. The new combined bonds balance bears interest at a variable rate

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

ranging from 3.00% to 7.30%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2008	\$ —	16,907	16,907
2009	—	16,907	16,907
2010	3,415	16,793	20,208
2011	9,390	16,443	25,833
2012	7,280	16,132	23,412
2013 – 2017	67,375	71,494	138,869
2018 – 2022	85,810	51,852	137,662
2023 – 2027	107,240	26,353	133,593
2028 – 2030	47,985	2,248	50,233
Total	328,495	\$ 235,129	563,624
Less unamortized discount	(599)		
Less deferred charges arising from debt refunding	(47,739)		
Total	\$ 280,157		

During fiscal year 1996, the Commonwealth refinanced the liability for the settlement of the property taxes owed to the municipalities of Puerto Rico. Commonwealth appropriation bonds were issued to refund this liability. The new combined bonds balance bears interest at rates ranging from 5.87% to 7.25%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2008	\$ 15,350	3,040	18,390
2009	16,505	1,885	18,390
2010	31,563	5,225	36,788
2011	13,001	5,389	18,390
2012	12,184	6,211	18,395
2013 – 2016	22,247	14,553	36,800
Total	110,850	\$ 36,303	147,153
Plus accreted discount	8,962		
Less deferred charges arising from debt refunding	(24,893)		
Total	\$ 94,919		

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

**(e) *Qualified Zone Academy Bonds***

During November 2001, the Department of Education of the Commonwealth issued a certification whereby certain Commonwealth public schools were designated as a “qualified zone academy” pursuant to Section 1397E of the U.S. Internal Revenue Code of 1986, as amended. On May 18, 2004, PFC, a blended component unit of GDB, issued \$47.9 million of Qualified Zone Academic Bonds (QZAB) to finance expenditures of the Department of Education of the Commonwealth under the aforementioned program, including rehabilitation and repairs of school buildings and other facilities, the development and implementation of academic curricula, technology training for some schools, and the costs of issuance of the bonds. This May 2004 QZAB is payable upon its maturity on May 2020, since the U.S. government grants tax exemptions to bond holders in lieu of an interest rate.

During January 2006, another QZAB in the amount of \$39.4 million was issued for similar purposes. The January 2006 QZAB is payable upon its maturity in January 2022.

Also during January 2006, the Commonwealth unwound the 2001 defeasance of the QZAB issued in December 2001, therefore, reverting back the transaction and recognizing in the statement of net assets for the governmental activities such QZAB obligation in the amount of \$96.8 million.

During fiscal year 2007 annual appropriations of \$12.4 million for the future settlement of the QZABs were not provided by the general fund as it was originally intended. Instead, annual required escrow deposits were funded with monies borrowed by PFC. These advances from PFC would be repaid by COFINA under the same mechanism fully described in note 14 (d).

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2007

**(f) Notes Payable to Component Units**

The Commonwealth has entered into various interim line-of-credit agreements with GDB consisting of the following at June 30, 2007 (expressed in thousands):

<u>Agency</u>	<u>Purpose</u>	<u>Interest rate</u>	<u>Line of credit</u>	<u>Outstanding balance</u>
Department of the Treasury	Resources to meet appropriations in annual budget of the Commonwealth (fiscal year 2004) and Federal program expenditures	125bp over three-month LIBOR	\$ 640,000	156,744
Public Buildings Authority	Interim construction activities	150bp over GDB's commercial paper rate	256,000	129,112
Department of Transportation and Public Works	Construction and repavement of roads	150bp over GDB's commercial paper rate	15,000	11,604
Department of Recreation and Sports	Recreational projects at various municipalities	150bp over GDB's commercial paper rate	16,000	1,615
			<u>\$ 927,000</u>	<u>299,075</u>



## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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The Commonwealth financed certain other long-term liabilities through GDB and other component units. The outstanding balance on the financing provided by GDB comprises the following (expressed in thousands), all within governmental activities:

#### **GDB:**

Department of the Treasury	\$ 2,173,659
Department of Health	301,101
Department of Education	124,539
Public Buildings Authority	75,000
Office of Management and Budget	74,772
Department of Transportation and Public Works	68,640
Department of Agriculture	61,173
Department of Justice	49,176
The Children's Trust	42,000
Puerto Rico Court Administration Office	35,092
Police Department	23,143
Department of Recreation and Sports	22,755
Public Housing Administration	21,847
Department of Housing	16,688
Correction Administration	11,892
Office of the Superintendent of the Capitol	9,885
Administration for the Care and Development of the Childhood	5,257
Department of Natural and Environmental Resources	3,056
State Office for the Historic Conservation	2,252
Office of Veterans' Affairs	1,135
Notes payable to GDB	<u>\$ 3,123,062</u>

#### **Other Components Unit:**

Health facilities agreement payable to the Medical Science Campus of UPR	\$ 63,785
Note payable to PREPA	<u>43,081</u>
Notes payable to other component units	<u>\$ 106,866</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

As of June 30, 2007, the Department of the Treasury of the Commonwealth has entered into various line-of-credit agreements with GDB amounting to a maximum of \$2.4 billion for different purposes as presented in the following tables. The purpose, interest rate, maturity date, and amount outstanding under each individual agreement at June 30, 2007 consist of the following (expressed in thousands):

Purpose	Interest rate	Maturity	Line of credit	Outstanding balance
To finance payroll and operational expenditures of the Commonwealth for fiscal year 2006	5.50%	June 30, 2036	\$ 741,000	741,000
To provide additional resources to meet the appropriations in the annual budget of the Commonwealth for fiscal year 2005	125 bp over three-month LIBOR	June 30, 2014	550,000	550,000
Replenishment of income tax refund reserve for fiscal year 2004	125 bp over three-month LIBOR	June 30, 2008	250,000	238,924
Resources to meet appropriations in annual budget of Commonwealth and partial repayments of TRANS (fiscal year 2004)	125 bp over three-month LIBOR	June 31, 2009	233,000	233,000
Capital improvement projects of agencies and municipalities	150 bp over GDB's commercial paper rate	June 30, 2019	130,000	91,035
Acquisition of safety and security equipment for certain Commonwealth agencies	150 bp over GDB's commercial paper rate	September 30, 2007	105,000	79,832
Resources to cover the operational needs of the catastrophic disasters fund (fiscal year 2004)	125 bp over three-month LIBOR	September 30, 2012	100,000	78,130
Balance brought forward			\$ 2,109,000	2,011,921

# COMMONWEALTH OF PUERTO RICO

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Purpose	Interest rate	Maturity	Line of credit	Outstanding balance
Balance brought forward			\$ 2,109,000	2,011,921
To meet program expenditures of the Puerto Rico Health Insurance Administration and the Department of the Family	125 bp over three-month LIBOR	September 30, 2015	79,930	43,392
To cover deficit in certain elderly and child care programs of the Department of the Family	125 bp over three-month LIBOR	September 30, 2011	30,000	29,928
To fund information technology project	150 bp over GDB's commercial paper rate	June 30, 2008	44,868	14,783
To pay debt with Municipal Revenue Collection Center	125 bp over three-month LIBOR	June 30, 2011	16,241	16,241
Resources to various agencies to pay outstanding debt with PBA	125bp over three-month LIBOR	September 30, 2008	40,000	14,182
To stimulate economy in municipalities of Ceiba and Naguabo	125 bp over three-month LIBOR	September 30, 2012	14,500	12,665
To pay outstanding debt of various agencies with the Puerto Rico Telephone Company	125 bp over three-month LIBOR	September 30, 2008	16,000	12,157
To acquire correctional facilities	125 bp over three-month LIBOR	June 30, 2010	15,000	9,868
Resources to cover the operational needs of the catastrophic disasters fund (fiscal year 2004)	125 bp over three-month LIBOR	July 31, 2007	8,000	5,825
Purchase of mobile X-ray machines	125 bp over three-month LIBOR	June 30, 2008	12,000	2,697
			<u>\$ 2,385,539</u>	<u>2,173,659</u>

On November 17, 2006, Act No. 249 was enacted creating the Special Health Fund (SHF), ascribed to the DOH, to cover budgetary deficiencies at the Puerto Rico Health Insurance Administration (PRHIA) in the implementation of the health reform and to finance the needs of the Puerto Rico Medical Services Administration (PRMSA) in the treatment and trauma programs. Act. No. 249 authorized GDB to provide funding to the SHF up to a maximum of \$253 million to finance these

## COMMONWEALTH OF PUERTO RICO

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needs. On December 22, 2006, GDB provided the aforementioned financing, payable in annual installments for a term of six years until 2013, beginning on September 15, 2007, including interest at the rate of 7.50%. The source of the repayment will come from annual contributions from the State Insurance Fund Corporation, which in turn are expected to be funded with future Commonwealth appropriations for the same amounts. As of June 30, 2007, this line of credit amounted to \$253 million.

On August 2003, the Department of Health of the Commonwealth entered into a \$30 million line-of-credit agreement with GDB in order to repay certain outstanding debts that the PRMSA had with other agencies and suppliers. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon maturity of the line of credit on June 30, 2012. As of June 30, 2007, \$28.9 million related to this line-of-credit agreement was outstanding. On November 8, 2004, the Department of Health entered into an additional \$58.5 million line-of-credit agreement with GDB for the financing of a project of the Department of Health and PRMSA. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on October 31, 2014. As of June 30, 2007, this line-of-credit agreement amounted to \$19.2 million.

On February 6, 2003, the Department of Education of the Commonwealth entered into a \$25 million line-of-credit agreement with GDB for the purchase of equipment and for school improvements. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2008. As of June 30, 2007, \$9.5 million was outstanding. On August 4, 2002, the Department of Education of the Commonwealth entered into an additional \$140 million line-of-credit agreement with GDB in order to reimburse the Department of the Treasury of the Commonwealth for payments made on their behalf for state funds used to fund federal program expenditures. Borrowings under this line of credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2007. As of June 30, 2007, \$115 million was outstanding related to the borrowing. The line of credit will be repaid with federal grants. On August 30, 2002, the Department of Education of the Commonwealth also entered into a \$2.3 million line-of-credit agreement with GDB for the construction of school facilities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on July 1, 2006. At June 30, 2007, no amounts had been drawn under this line of credit.

On April 6, 2006, the Public Buildings Authority executed a loan agreement with GDB for \$75 million bearing interest at a variable rate based on 125 basis points over the three-month London Interbank Offered Rate (LIBOR) index. The loan, obtained for operational needs, is due on June 30, 2010 and is collateralized with two of PBA's properties. At June 30, 2007, \$75 million remained outstanding.

On June 5, 2006, the Office of Management and Budget entered into a \$150 million line-of-credit agreement with GDB to provide economic assistance for disasters and emergencies. Borrowings under this line-of-credit agreement bear interest at variable rates based on 125 basis points over three-month LIBOR, and are payable upon the maturity of the line of credit on September 30, 2011. As of June 30, 2007, \$74.8 million was outstanding.

## COMMONWEALTH OF PUERTO RICO

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On March 8, 2004, the Department of Transportation and Public Works (DTPW), entered into a \$26 million line-of-credit agreement with GDB for the improvement and maintenance of the roads around the island. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2010. As of June 30, 2007, this line of credit has an outstanding balance of approximately \$21.2 million. On November 16, 2004, the DTPW entered into another \$33 million line-of-credit agreement with GDB for similar purposes. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on October 31, 2010. As of June 30, 2007, \$14.4 million remains outstanding related to these borrowings. On June 23, 2005, the DTPW entered into an additional \$44 million line-of-credit agreement with GDB to meet program expenditures. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 2.5% and are payable upon the maturity of the line of credit on September 30, 2008. As of June 30, 2007, this line of credit has an outstanding balance of approximately \$33 million. On June 29, 2006, all three mentioned line-of-credit agreements were amended in order to change interest rates, from a variable rate based on 125 basis over GDB's commercial paper to the interest stated above.

On August 9, 1999, the Department of Agriculture of the Commonwealth entered into a \$125 million nonrevolving line-of-credit agreement with GDB to provide economic assistance to the agricultural sector, which sustained severe damages caused by Hurricane Georges in 1998. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2014. As of June 30, 2007, \$61.2 million remains outstanding.

On October 2, 2002, the Department of Justice of the Commonwealth entered into a \$90 million line-of-credit agreement with GDB for the financing of 12 public improvement projects for the Municipality of Ponce pursuant to a court order. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2014. As of June 30, 2007, \$21.5 million related to this line-of-credit agreement was outstanding. On July 8, 2005, the Department of Justice of the Commonwealth entered into an additional \$63.4 million line-of-credit agreement with GDB for various projects in Ponce. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2014. As of June 30, 2007, this line-of-credit agreement amounted to \$27.6 million.

On June 29, 2007, The Trust entered into a loan agreement with GDB to advance the payment of grants to the Department of Health. This loan bears variable interest of 4.15% subject to tax exempt commercial paper. The loan's outstanding balance at June 30, 2007 was \$42 million and matures on December 29, 2007. Principal and interest are payable from a future issuance of the tobacco settlement asset-backed bonds.

On May 7, 2001, the Puerto Rico Court Administration Office (the Office) entered into a \$49.4 million nonrevolving line-of-credit agreement with GDB for operating purposes. Borrowings under this line-of-credit agreement bear interest at a variable rate of three-month LIBOR plus 1%, not to exceed 8%. The Office must deposit \$6 million a year, from the total fees collected on the filing of civil cases, in a special fund created by the Department of the Treasury of the Commonwealth, which is pledged for repayment until July 31, 2015. As of June 30, 2007, approximately \$35 million remains outstanding.

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On July 29, 2004, the Police Department entered into a \$48 million line-of-credit agreement with GDB for the acquisition of vehicles and high technology equipment. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2014. The outstanding balance of this line-of-credit agreement amounted to \$23.1 million at June 30, 2007.

On October 23, 2002, the Department of Recreation and Sports of the Commonwealth (DRS) entered into a \$17.5 million line-of-credit agreement with GDB for the development of a recreational complex and other facilities in San Juan, which will eventually become the DRS' principal office headquarters. During fiscal year 2007, this line of credit was combined with a May 25, 2006 line of credit issued for an additional \$3 million for the development of a series of recreational projects at different municipalities. Borrowings under this combined line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2008. As of June 30, 2007, \$13 million was outstanding. On January 18, 2005, the DRS also entered into a \$17.2 million line-of-credit agreement with GDB for the development of a series of recreational projects at different municipalities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2010. As of June 30, 2007, \$9.7 million was outstanding.

The Public Housing Administration has available a \$97.1 million of a line of credit secured by the Department of Housing and Urban Development of the United States of America. It bears interest at the daily weighted average rate of the GDB outstanding commercial paper notes plus a required margin cost (5.67% at June 30, 2006). At June 30, 2007, the outstanding balance under this line of credit was \$21.8 million.

On March 8, 2007, the Department of Housing and entered into a \$19 million line-of-credit agreement with GDB, to reimburse the Puerto Rico Housing Finance Authority, a blended component unit of GDB for certain advances made for the Santurce Revitalization Program. Borrowings under this line-of-credit agreement bear interest at a variable rate of three-month LIBOR plus 1.25%, not to exceed 4% and are payable upon the maturity of the line of credit on March 15, 2009. It also can be prepaid without any penalty during said term. The line of credit will be repaid from the proceeds on the sale and development of the properties acquired under the Revitalization Program. As of June 30, 2007, the line of credit has an outstanding balance of \$16.7 million.

On August 28, 2000, GDB approved an amendment to the terms of two line-of-credit agreements of the Correction Administration by which such debts would be repaid between fiscal years 2000 and 2007. The two agreements were issued by GDB in August 1998 to partially fund permanent improvements to correctional facilities. The agreements have variable interest rates and limits of \$60 million and \$15 million. These two lines of credits were fully repaid during fiscal year 2007. On May 12, 2004, the Correction Administration entered into an additional \$60 million line-of-credit agreement with GDB for improvements to certain correctional facilities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2010. As of June 30, 2007, \$11.9 million was outstanding.

On June 21, 2001, the Office of the Superintendent of the Capitol (Superintendent) entered into a \$10 million line-of-credit agreement with GDB for the construction of a parking lot. Borrowings

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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under this line-of-credit agreement bear interest at a fixed rate of 8% and are payable from Commonwealth appropriations commencing in fiscal year 2003 through fiscal year 2007. As of June 30, 2007, \$2.9 million related to the line-of-credit agreement remained outstanding. On February 15, 2002, the Superintendent entered into an additional \$35 million line-of-credit agreement with GDB for the acquisition and remodeling of several buildings under their jurisdiction. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 8% and have been payable through fiscal year 2008. As of June 30, 2007, \$6.9 million remained outstanding from the line-of-credit agreement.

On February 24, 2006 the Administration for the Care and Development of the Childhood entered into an \$8 million line-of-credit agreement with GDB to provide economic assistance for the summer program known as "Care and Development of the Child Program". Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2009. As of June 30, 2007, \$5.3 million was outstanding.

On August 21, 2002, the Department of Natural and Environmental Resources of the Commonwealth entered into a \$22.7 million line-of-credit agreement with GDB for the canalization of the Bucana River. Borrowings under this line-of-credit agreement carried interest at variable rates and were fully repaid on its maturity at June 30, 2007. On September 3, 2003, the DNER entered into a \$2 million line-of-credit agreement with GDB for the canalization of Guayanilla River. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2007. As of June 30, 2007, \$56 thousands remained outstanding. On August 22, 2005, the DNER entered into an additional \$3.5 million line-of-credit agreement with GDB for the canalization of Fajardo River. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2007. As of June 30, 2007, \$3 million was outstanding.

On August 1, 2001, the State Office for the Historic Conservation entered into a \$4.5 million line-of-credit agreement with GDB for the construction and conservation of the Santa Catalina Palace and the Real Audience building. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on December 31, 2008. As of June 30, 2007, the outstanding balance of this line-of-credit agreement amounts to \$2.3 million.

On October 20, 2004, the Office of Veterans' Affairs entered into a \$1.6 million line-of-credit agreement with GDB to provide economic assistance and housing-leasing services to Puerto Rican veterans. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2006. As of June 30, 2007, \$1.1 million was outstanding.

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As of July 1, 1999, debts of approximately \$102 million payable to UPR, a discretely presented component unit, in relation to outstanding noninterest-bearing debt accumulated in prior years by HFSA were transferred to the Commonwealth. On September 7, 2004, additional debts of approximately \$71.2 million were also restructured and combined with the previous financing arrangement. As of June 30, 2007, \$63.8 million remains outstanding. Future amounts required to pay principal balances at June 30, 2007 are expected to be as follows (expressed in thousands):

Year ending June 30:		
2008	\$	23,355
2009		7,570
2010		7,570
2011		7,570
2012		8,000
2013 – 2015		9,720
Total	\$	<u>63,785</u>

The noninterest-bearing note payable to PREPA, a discretely presented component unit, consists of \$19 million of fuel adjustment subsidy due by the Commonwealth and the refinancing during 2004 of \$24.1 million of other accumulated debt by the Commonwealth's agencies with PREPA. Future amounts required to pay principal balances at June 30, 2007 are expected to be as follows (expressed in thousands):

Year ending June 30:		
2008	\$	12,654
2009		6,327
2010		24,100
Total	\$	<u>43,081</u>

With the exception of a few lines of credit having a defined source of repayment, the remaining lines of credit described above used Commonwealth appropriations as the source of repayment until June 30, 2007. Beginning with fiscal year 2008, these lines of credit are expected to be repaid or refunded with a combination of Commonwealth appropriations and COFINA under the mechanism fully described in note 14(d).

**(g) *Compensated Absences***

Long-term debt includes approximately \$1,800 million of accrued vacation and sick leave benefits at June 30, 2007. The total liability of compensated absences recorded as governmental and business-type activities amounted to \$1,794 million and \$6 million, respectively.

**(h) *Net Pension Obligation***

The amount reported as net pension obligation of approximately \$5.1 billion represents the cumulative amount owed by the Commonwealth for the unfunded prior years' actuarially required pension contributions to the ERS and the TRS (collectively known as the pension plans)



# COMMONWEALTH OF PUERTO RICO

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(see note 19). The net pension obligation has been recorded as a liability in governmental activities in the accompanying statement of net assets.

### (i) *Unpaid Lottery Prizes*

The amount reported as unpaid lottery prizes represents the lottery prizes payable of the Lottery of Puerto Rico (commonly known as Traditional Lottery) and the Additional Lottery System (commonly known as Lotto) jointly known as the Lottery Systems at June 30, 2007. The minimum annual payments related to unpaid awards of both lotteries are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year(s) ending June 30:			
2008	\$ 55,377	3,489	58,866
2009	31,547	5,151	36,698
2010	29,968	6,730	36,698
2011	28,468	8,230	36,698
2012	24,836	8,856	33,692
2013 – 2017	81,959	45,841	127,800
2018 – 2022	32,844	32,307	65,151
2023 – 2026	7,291	10,211	17,502
Total	<u>\$ 292,290</u>	<u>120,815</u>	<u>413,105</u>

The liability for unpaid lottery prizes is reported in the accompanying statement of net assets and the statement of net assets – business-type activities – proprietary funds.

### (j) *Claims Liability for Insurance Benefits*

The Commonwealth provides unemployment compensation, nonoccupational disability, and drivers' insurance coverage to public and private employees through various insurance programs administered by the Department of Labor and Human Resources of the Commonwealth. These insurance programs cover workers against unemployment, temporary disability, or death because of work- or employment-related accidents or because of illness suffered as a consequence of their employment.

The Commonwealth establishes liabilities for incurred but unpaid benefits and benefit adjustment expenses based on the ultimate cost of settling the benefits. Insurance benefit claim liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. The liability for insurance benefits claims is reported as a current liability in the accompanying statement of net assets and the statement of net assets – business-type activities – proprietary funds.

### (k) *Obligations under Capital Lease Arrangements*

The Commonwealth is obligated under capital leases with third parties that expire through 2034 for land, buildings, and equipment. At June 30, 2007, the capitalized cost of the land, buildings, and

# COMMONWEALTH OF PUERTO RICO

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equipment amounted to approximately \$167 million and is included in the accompanying government-wide statement of net assets within capital assets.

The present value of future minimum capital lease payments at June 30, 2007 reported in the accompanying government-wide statement of net assets is as follows (expressed in thousands):

Year(s) ending June 30:

2008	\$	15,818
2009		14,811
2010		14,569
2011		14,258
2012		13,886
2013 – 2017		66,943
2018 – 2022		57,883
2023 – 2027		56,934
2028 – 2032		46,252
2033 – 2037		1,708
Total future minimum lease payments		303,062
Less amount representing interest costs		(161,251)
Present value of minimum lease payments	\$	<u>141,811</u>

Leased land, buildings, and equipment under capital leases in capital assets at June 30, 2007, include the following (expressed in thousands):

Land	\$	7,960
Buildings		146,202
Equipment		<u>12,401</u>
Subtotal		166,563
Less accumulated amortization		<u>(28,661)</u>
Total	\$	<u>137,902</u>

Amortization charge applicable to capital leases and included within depreciation expense of capital assets amounted to approximately \$5 million in 2007.

The Commonwealth is also committed under numerous operating leases, covering land, office facilities, and equipment. Rental expenditures within the governmental funds for the year ended June 30, 2007 under such operating leases were approximately \$148 million.

## COMMONWEALTH OF PUERTO RICO

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The future minimum lease payments for these leases are as follows (expressed in thousands):

Year(s) ending June 30:

2008	\$	108,166
2009		83,547
2010		55,698
2011		41,444
2012		29,183
2013 – 2017		64,943
2018 – 2022		4,957
2023 – 2027		2,013
Total future minimum lease payments	\$	<u>389,951</u>

**(l) Other Long-Term Liabilities**

The remaining long-term liabilities of governmental activities at June 30, 2007 include (expressed in thousands):

Employees' Christmas bonus	\$	100,074
Liability for federal cost disallowances		50,159
Liability for legal claims and judgments (note 18)		950,276
Liability to U.S. Army Corps of Engineers (note 12)		205,000
Total	\$	<u>1,305,509</u>

As described in note 12, the Commonwealth has a debt obligation with the U.S. Army Corps of Engineers in relation to the construction of the Cerrillos Dam and Reservoir project and the Portugues river and the Bucana river projects.

**(m) Advance Refunding, Defeased Bonds, and Refunding of Special Promissory Notes**

In prior years, the Commonwealth defeased certain general obligation and other bonds by placing the proceeds of the bonds in an irrevocable trust to provide for all future debt service payments on the refunded bonds. Accordingly, the trust's account assets and liabilities for the defeased bonds are not included in the basic financial statements. At June 30, 2007, approximately \$1.5 billion of bonds outstanding from prior years advance refunding are considered defeased.

In addition, PBA, a blended component unit, has defeased certain revenue bonds in prior years by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old debts. Accordingly, the trust's account assets and liabilities for the defeased bonds are not included in the statement of net assets. As of June 30, 2007, approximately \$655 million of PBA bonds are considered defeased.

## COMMONWEALTH OF PUERTO RICO

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#### Fiduciary Funds

On June 29, 2006, the ERS entered into a credit agreement with a financial institution in which loans could be made from time to time in the aggregate principal amount not exceeding \$112 million. The outstanding balance of \$60 million at June 30, 2006 was fully repaid during fiscal year 2007.

On August 1, 1996, the TRS entered into a loan agreement with AFICA, a discretely presented component unit, to secure AFICA's issuance of \$26.9 million of industrial revenue term bonds. The bonds were issued under a trust agreement and are secured by a pledge of certain marketable securities of the TRS. The proceeds from the sale of the bonds were lent by AFICA to TRS to finance the acquisition of certain buildings and related facilities and to pay certain expenses incurred in connection with the issuance and sale of the bonds.

On March 15, 2007, the bonds were paid in full from the TRS assets and from the TRS account with the trustee. Once the bonds were paid in full, the pledged collateral was released and contributed to TRS investment portfolio. The following is a summary of changes in the bonds payable principal balance (expressed in thousands):

	<b>Balance</b> <b>June 30, 2006</b>	<b>Additions</b>	<b>Deductions</b>	<b>Balance</b> <b>June 30, 2007</b>
6.65% Term Bonds Series A due July 1, 2011	\$ 5,220	—	5,220	—
5.50% Term Bonds Series B due July 1, 2016	6,575	—	6,575	—
5.50% Term Bonds Series B due July 1, 2021	8,635	—	8,635	—
Total	<u>\$ 20,430</u>	<u>—</u>	<u>20,430</u>	<u>—</u>

#### Discretely Presented Component Units

Notes and bonds payable are those liabilities that are paid out of the component units' own resources. These notes and bonds do not constitute a liability or debt of the Commonwealth.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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The outstanding balance of notes payable at June 30, 2007 is as follows (expressed in thousands):

Component unit	Interest rate	Maturity through	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Government Development Bank for Puerto Rico	4.1% – 7.5%	2031	\$ 2,734,957	2,440,380	2,895,424	2,279,913	692,846
Puerto Rico Electric Power Authority	2.60% – 5.47%	2012	411,835	452,850	9,624	855,061	387,277
State Insurance Fund Corporation	Discounted notes from 6.31% to 6.84%	2019	53,592	—	1,956	51,636	2,278
Economic Development Bank for Puerto Rico	4.18% – 5.22%	2025	500,000	—	—	500,000	—
Puerto Rico Industrial Development Company	5.00% – 6.73%	2025	68,319	31,705	3,543	96,481	4,382
Land Authority of Puerto Rico	4.87	2010	8,483	—	2,121	6,362	2,121
Puerto Rico Ports Authority	Variable	2028	134,949	446,305	30,353	550,901	127,091
Agricultural and Services Development Administration	Variable	2007	10,238	—	405	9,833	9,833
Puerto Rico Trade & Export Company	5.20% – 6.20%	2026	400,000	50,000	200,000	250,000	—
Puerto Rico Aqueduct and Sewer Authority	6.51%	2012	—	250,000	—	250,000	—
Puerto Rico Metropolitan Bus Authority	Variable	2012	—	46,000	430	45,570	4,720
Total notes payable – component units			\$ 4,322,373	3,717,240	3,143,856	4,895,757	1,230,548

Debt service requirements on component units' notes payable with fixed maturities at June 30, 2007 were as follows (expressed in thousands):

	Principal	Interest	Total
Year(s) ending June 30:			
2008	\$ 1,230,548	220,642	1,451,190
2009	147,064	200,717	347,781
2010	485,696	176,220	661,916
2011	91,900	164,235	256,135
2012	406,052	147,184	553,236
2013 – 2017	524,439	591,249	1,115,688
2018 – 2022	440,161	514,802	954,963
2023 – 2027	649,640	355,464	1,005,104
2028 – 2032	920,170	196,918	1,117,088
Premium, net	87	—	87
Total	\$ 4,895,757	2,567,431	7,463,188

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Commonwealth appropriation bonds payable outstanding at June 30, 2007 are as follows (expressed in thousands):

Component unit	Interest rate	Maturity through	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Puerto Rico Aqueduct and Sewer Authority	4% – 6.15%	2031	\$ 1,072,286	8,189	9,307	1,071,168	18,409
Puerto Rico Tourism Company	4% – 6.15%	2031	126,527	—	409	126,118	1,916
Land Authority of Puerto Rico	4% – 6.15%	2031	163,335	—	719	162,616	613
Government Development Bank for Puerto Rico	4% – 6.15%	2031	10,244	—	45	10,199	39
Puerto Rico Infrastructure Financing Authority	7.50%	2031	10,553	—	46	10,507	40
Puerto Rico Solid Waste Authority	1.25% – 5.75%	2031	7,701	—	—	7,701	—
Total appropriation bonds – component units			\$ 1,390,646	8,189	10,526	1,388,309	21,017

Debt service requirements on component units' appropriation bonds payable with fixed maturities at June 30, 2007 were as follows (expressed in thousands):

	Principal	Interest	Total
Year(s) ending June 30:			
2008	\$ 21,017	77,173	98,190
2009	23,976	76,130	100,106
2010	23,767	74,956	98,723
2011	22,115	75,388	97,503
2012	23,122	75,098	98,220
2013 – 2017	158,582	293,377	451,959
2018 – 2022	230,333	235,291	465,624
2023 – 2027	340,806	165,566	506,372
2028 – 2032	566,016	51,577	617,593
Premium	44,441	—	44,441
Deferred loss, net	(65,866)	—	(65,866)
Total	\$ 1,388,309	1,124,556	2,512,865

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Bonds payable outstanding at June 30, 2007 are as follows (expressed in thousands):

Component unit	Interest rate	Maturity through	Beginning balance (as restated)	Additions	Reductions	Ending balance	Amounts due within one year
Government Development for Puerto Rico	Variable	2038	\$ 1,380,097	150,664	247,507	1,283,254	70,698
Puerto Rico Infrastructure Financing Authority	Variable	2046	2,582,257	547,899	32,553	3,097,603	32,225
University of Puerto Rico	3% – 5.75%	2030	466,186	575,494	303,828	737,852	22,790
Puerto Rico Municipal Finance Authority	3.50% – 8.62%	2031	1,616,565	—	118,622	1,497,943	99,035
Puerto Rico Ports Authority	5.00% – 7.30%	2021	66,204	205	4,545	61,864	4,855
Puerto Rico Aqueduct and Sewer Authority	3.5% – 8.22%	2044	463,840	850,000	17,187	1,296,653	19,989
Puerto Rico Highways and Transportation Authority	2.25% – 6.50%	2046	6,641,212	2,712,362	2,348,324	7,005,250	66,020
Puerto Rico Industrial Development Company	1.50% – 6.71%	2029	289,972	1,621	10,458	281,135	6,992
Puerto Rico Convention Center District Authority	4.00% – 5.00%	2037	482,589	—	867	481,722	3,000
Puerto Rico Electric Power Authority	3.00% – 7.00%	2037	5,156,530	2,531,369	2,040,190	5,647,709	361,694
Total bonds – component units			<u>\$ 19,145,452</u>	<u>7,369,614</u>	<u>5,124,081</u>	<u>21,390,985</u>	<u>687,298</u>

Debt service requirements on component units' bonds payable with fixed maturities at June 30, 2007 were as follows (expressed in thousands):

	Principal	Interest	Total
Year(s) ending June 30:			
2008	\$ 687,298	1,083,444	1,770,742
2009	1,362,174	932,497	2,294,671
2010	735,553	900,659	1,636,212
2011	548,535	869,198	1,417,733
2012	566,206	843,151	1,409,357
2013 – 2017	3,695,113	3,733,004	7,428,117
2018 – 2022	3,307,507	2,909,528	6,217,035
2023 – 2027	3,442,964	2,150,737	5,593,701
2028 – 2032	2,634,643	1,844,306	4,478,949
2033 – 2037	2,224,897	1,088,022	3,312,919
2038 – 2042	1,846,833	403,480	2,250,313
2043 – 2046	676,224	332,506	1,008,730
Discount, net	(336,962)	—	(336,962)
Total	<u>\$ 21,390,985</u>	<u>17,090,532</u>	<u>38,481,517</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Several component units have defeased certain revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old debts. Accordingly, the trust accounts' assets and liabilities for the defeased bonds are not included in the statement of net assets. As of June 30, 2007, the following bonds are considered defeased:

	<b>Amount outstanding</b> (In millions)
Puerto Rico Electric Power Authority	\$ 3,224
Puerto Rico Highways and Transportation Authority	3,169
Puerto Rico Infrastructure Financing Authority	699
Puerto Rico Municipal Finance Agency	300
	<u>\$ 7,392</u>

### (15) Guaranteed and Appropriation Debt

#### (a) *Guaranteed Debt*

The Commonwealth may provide guarantees for the repayment of certain borrowings of component units to carry out designated projects. At June 30, 2007, the following component unit debts are guaranteed by the Commonwealth (expressed in thousands):

	<b>Maximum guarantee</b>	<b>Outstanding balance</b>
Blended component unit:		
Public Buildings Authority	\$ 3,325,000	2,789,927
Discretely presented component units:		
Puerto Rico Aqueduct and Sewer Authority	838,623	716,158
Port of the Americas Authority (a component unit of Puerto Rico Infrastructure Financing Authority)	250,000	87,390
Government Development Bank for Puerto Rico	342,000	267,000
Total	<u>\$ 4,755,623</u>	<u>3,860,475</u>



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

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The Commonwealth has guaranteed the payments of rentals of its departments, agencies, and component units to PBA, a blended component unit, under various lease agreements executed pursuant to the law that created PBA. Such rental payments include the amounts required by PBA for the payment of principal and interest on the guaranteed debt as authorized by law. The rental commitment to cover principal and interest on the guaranteed debt (excluding premiums and deferred refunding losses) as of June 30, 2007 and for the next five years and thereafter follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year(s) ending June 30:			
2008	\$ 75,690	138,934	214,624
2009	80,684	134,992	215,676
2010	86,740	128,120	214,860
2011	89,455	123,273	212,728
2012	85,802	132,313	218,115
2013 – 2017	396,795	560,261	957,056
2018 – 2022	380,545	449,027	829,572
2023 – 2027	433,080	353,042	786,122
2028 – 2032	507,369	275,211	782,580
2033 – 2037	694,105	86,674	780,779
	<u>2,830,265</u>	<u>2,381,847</u>	<u>\$ 5,212,112</u>
Add (deduct) accreted discount	29,277	(29,277)	
Unamortized premiums, discounts, and deferred losses, net	<u>(69,615)</u>	<u>—</u>	
	<u>\$ 2,789,927</u>	<u>2,352,570</u>	

Rental income of PBA funds amounted to approximately \$290 million during the year ended June 30, 2007, of which \$214 million was used to cover debt service obligations.

Act No. 45 of July 28, 1994 states that the Commonwealth guarantees the payment of principal and interest of all outstanding bonds at the date the law was enacted and of all future bond issues to refinance those outstanding bonds of PRASA. During December 1995, PRASA issued refunding bonds to refinance all outstanding bonds amounting to approximately \$400 million. The outstanding balance of these refunding bonds at June 30, 2007 amounted to \$277.8 million. Act No. 140 of August 3, 2000 amended Act No. 45 to extend the commonwealth guarantee to include the principal and interest payments of the Rural Development Serial Bonds and the loans under the State Revolving Fund Program (SRFP) outstanding at the effective date of Act No. 140, and of all future bonds and SRFP loans that may be issued until June 30, 2005. Act No. 386 of September 21, 2004 extended the commonwealth guarantee to June 30, 2010. The outstanding balance of the Rural Development Serial Bonds and SRFP loans at June 30, 2007 amounted to \$209.2 million and \$229.2 million, respectively.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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The Commonwealth guarantees the Adjustable Refunding Bonds, Series 1985, issued by GDB, a discretely presented component unit. The outstanding balance of these bonds amounts to \$267 million at June 30, 2007. The Puerto Rico Housing Bank, a former component unit of the Commonwealth, which merged with and into GDB during 2002, insured mortgages granted to low- and moderate-income families through its mortgage loan insurance program. The Commonwealth guarantees up to \$75 million of such mortgage loans. As of June 30, 2007, the mortgage loan insurance program was insuring loans aggregating \$203 million. Currently, the Commonwealth has not been called to make any direct payments pursuant to these guarantees.

At various times during fiscal years ended 2005 and 2006, the Port of the Americas Authority, currently a component unit of the Puerto Rico Infrastructure Financing Authority, entered into bond purchase agreements with GDB, whereby GDB agreed to disburse to the Port of the Americas Authority from time to time certain bond principal advances up to a maximum aggregate principal amount of \$70 million (Port of the Americas Authority 2005 Series A Bond), \$40 million (Port of the Americas Authority 2005 Series B Bond), and \$140 million (Port of the Americas Authority 2005 Series C Bond). The proceeds of the bonds are to be used to finance the cost of development and construction of the Port of the Americas. The aggregate unpaid principal balance of all outstanding bond principal advances shall be payable in full on January 1, 2015. The principal amount may be paid with any of the following: a long-term bond issuance once the projects are completed, other revenue of the Port of the Americas Authority or legislative appropriations as established in Act 409 of September 22, 2004 (Act No. 409). Principal and interests payments are guaranteed by the Commonwealth by Act No. 409. As of June 30, 2007, the principal outstanding under those bond purchase agreements amounted to \$87.4 million.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

**(b) Appropriation Debt**

At June 30, 2007, the outstanding balances of debt payable by Commonwealth appropriations or sales and use tax revenue through COFINA, as described in note 14(d), which are included in the individual financial statements of the following discretely presented component units, are as follows (expressed in thousands):

Puerto Rico Aqueduct and Sewer Authority	\$ 1,071,168
Special Communities Perpetual Trust	385,152
Puerto Rico Public Finance Corporation (a blended component unit of GDB)	302,265
Land Authority of Puerto Rico	162,616
Puerto Rico Convention Center District Authority	155,221
Puerto Rico Tourism Company	126,118
Puerto Rico Solid Waste Authority	74,500
Agricultural Services and Development Administration	62,578
Puerto Rico Industrial Development Company	43,403
Puerto Rico Electric Power Authority	39,718
Puerto Rico Housing Finance Authority (a blended component unit of GDB)	25,564
Institute of Puerto Rican Culture	22,755
University of Puerto Rico	20,288
Puerto Rico Infrastructure Financing Authority	10,507
National Parks Company of Puerto Rico	3,830
Other governmental entities	31,128
Total	<u>\$ 2,536,811</u>

These balances are reported in the statement of net assets as Commonwealth appropriation bonds payable and notes payable.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### (16) Conduit Debt Obligations and No-Commitment Debt

From time to time, certain of the Commonwealth's component units issue revenue bonds to provide financial assistance to private-sector entities for the acquisition and construction of transportation, environmental, industrial, tourism, educational, and commercial facilities, deemed to be in the public interest and that are expected to provide benefits to Puerto Rico. These bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Upon repayment of the bonds, ownership of the acquired facilities is retained by the private-sector entity served by the bond issuance. Neither the Commonwealth nor any political subdivision or component unit thereof is obligated in any manner for the repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the basic financial statements of the issuing entities. As of June 30, 2007, conduit debt obligations consisted of the following bonds issued by component units (expressed in thousands):

Issuing entity	Issued since inception to date	Amount outstanding
Discretely presented component units:		
Puerto Rico Ports Authority	\$ 155,410	155,410
Puerto Rico Highways and Transportation Authority	270,000	157,024
Government Development Bank for Puerto Rico	663,000	619,000
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	5,973,000	1,582,000

#### (a) Puerto Rico Ports Authority (PRPA)

PRPA issued Special Facilities Revenue Bonds under the provisions of two trust agreements between PRPA and a private bank. The proceeds from the sale of the bonds were used to finance the construction, acquisition of equipment, and improvement of certain facilities at Luis Munoz Marin International Airport, for the benefit of a major private airline. The property is owned by PRPA and leased to the private company. Pursuant to the agreements between PRPA and the private company, the bonds will be paid from the rent collected from the airline in amounts sufficient to pay principal, premium (if any), and interest on the bonds. The airline has guaranteed these payments.

#### (b) Puerto Rico Highways and Transportation Authority (PRHTA)

In March 1992, PRHTA issued Special Facility Revenue Bonds for approximately \$117 million for the construction of a toll bridge. The proceeds from the sale of these bonds were transferred by PRHTA to a private entity, Autopistas de Puerto Rico (Autopistas), pursuant to a signed agreement for the construction, transfer, and operation of the bridge. On October 2003, PRHTA issued Special Facility Revenue Refunding Bonds, 2004 Series A, amounting to approximately \$153 million for the purpose of refunding the Authority's Special Facility Revenue Bonds, 1992 Series A, B, and C, which were issued to fund the construction of the bridge, and to pay the cost of issuance of the bonds. The bonds shall be paid from the proceeds received by Autopistas from the operation of the bridge.

Under certain circumstances, the concession agreement may be terminated and the authority is then obligated to assume the Autopista's entire obligation to pay principal of and interest, which pursuant

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

to the signed agreement, will be paid from the net revenues of the use and operation of the bridge. The authority does not currently expect the concession agreement to terminate. The outstanding bonds (including accrued interest) at June 30, 2007 amounted to approximately \$157 million.

**(c) GDB**

GDB, through its Housing Finance Authority, issued \$663 million in Capital Fund Program Bonds Series 2003 to fund PHA in its financing of improvements to various public low- and moderate-income housing projects. Certain of the obligations issued are considered no-commitment debt and are excluded, along with the related assets held in trust, from the accompanying basic financial statements. These bonds are limited obligations of the Housing Finance Authority, which will be paid solely from an annual allocation of public housing capital funds when received from the U.S. Department of Housing and Urban Development; accordingly, these bonds are considered no-commitment debt. The outstanding balance of these bonds amounted to \$619 million at June 30, 2007.

**(d) AFICA**

The revenue bonds of AFICA are used to finance facilities for environmental control, development of industrial and commercial companies, tourism projects, hospitals, and educational facilities. Pursuant to the loan agreements, the proceeds from the sales were borrowed by corporations and partnerships operating in Puerto Rico. The bonds are limited obligations of AFICA and, except to the extent payable from bond proceeds and investment thereof, will be payable solely from and secured by a pledge and assignment of the amounts payable under the loan agreements between AFICA and each borrower. Furthermore, payment of the principal and interest on the revenue bonds is unconditionally guaranteed by each of the borrowers, their parent companies, or letters of credit from major U.S. banks or U.S. branches of international banks.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### (17) Risk Management

The risk management program of the Commonwealth and most of its discretely component units are described in note 1(y). The following describes the risk management programs separately administered by certain discretely presented component units:

#### (a) UPR

UPR is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Through January 1993, UPR was insured under claims-made insurance policies with respect to medical malpractice risks for \$250,000 per occurrence up to an annual aggregate of \$500,000. Subsequent to such date, UPR was unable to obtain insurance at a cost it considered to be economically justifiable; consequently, UPR is now self-insured for such risks. Under Act No. 98 of August 24, 1994, the responsibility of UPR is limited to a maximum amount of \$75,000 per person, or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Self-insured risk liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend upon such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. Changes in the claims liability amount in fiscal years 2007 and 2006 were as follows (expressed in thousands):

	2007	2006
Claims payable – July 1	\$ 18,332	20,260
Incurred claims and changes in estimates	34,279	27,378
Payments for claims and adjustments expenses	(30,551)	(29,306)
Claims payable – June 30	\$ 22,060	18,332

UPR continues to carry commercial insurance for all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

#### (b) PREPA

PREPA is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The PREPA obtains insurance policies covering all-risk property (excluding transmission and distribution lines), boiler and machinery, and public liability. The all-risk property and boiler and machinery policies have a combined coverage of \$650 million per occurrence. The policies' self-retention in case of earthquake and windstorm losses is \$25 million and \$2 million for all other covered risks. The public general liability policy covers property damage and bodily injury to third parties with a \$75 million aggregate limit in excess of the self-retention limit of \$1 million per occurrence.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

PREPA has a cost plus health insurance program covering substantially all employees. PREPA contracted an administrator for the processing, approval, and payment of claims plus an administrative fee. The accrual for employees' health plan includes the liability for claims processed and an estimate for claims incurred but not reported.

In addition, PREPA is self-insured for its transmission and distribution lines. Transmission and distribution lines amounted to approximately \$3.6 billion at June 30, 2007. PREPA's self-insurance fund provides for its self-insurance risk. This fund represents principally net assets and restricted assets set aside for self-insurance amounting to approximately \$68.9 million at June 30, 2007.

Changes in the balances of the health insurance program and other self-insurance risks during fiscal years 2007 and 2006 were as follows (expressed in thousands):

	<u>2007</u>	<u>2006</u>
Claims payable at beginning of year	\$ 44,052	32,603
Incurred claims	139,238	130,755
Claim payments	<u>(134,034)</u>	<u>(119,306)</u>
Claims payable at end of year	<u>\$ 49,256</u>	<u>44,052</u>

(c) **PRASA**

PRASA is exposed to various risk losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Under the property insurance program, PRASA has \$600 million blanket insurance on all real and personal property. The deductible for windstorm and flood is 2%, and 5% for earthquake with a maximum amount of \$7.5 million, and \$3 million for flood. This policy has a general limit of \$10 million per occurrence.

The comprehensive general liability and automobile liability have basic limits of \$2 million and the umbrella is \$20 million in excess of \$2 million, per occurrence. Also, there is an excess of loss coverage of \$45 million for losses in excess of \$28 million. In the past three years, PRASA has not settled claims in excess of insurance coverage.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### (d) *SIFC*

SIFC provides workers' compensation insurance to public and private employees. This insurance covers workers against injuries, disability, or death because of work- or employment-related accidents, or because illness is suffered as a consequence of their employment. SIFC establishes liabilities for estimated incurred but unpaid benefits and benefit adjustment expenses based on the ultimate cost of settling the benefits. The following table provides a reconciliation of the beginning and ending liability for incurred but unpaid benefits and benefit adjustment expenses for the two most recent fiscal years (expressed in thousands):

	<u>2007</u>	<u>2006</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	\$ 696,922	733,762
Total incurred benefits	416,080	380,629
Total benefit payments	<u>(425,173)</u>	<u>(417,469)</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at end of year	\$ <u>687,829</u>	<u>696,922</u>

The liability for incurred but unpaid benefits and benefit adjustment expenses is reported as liabilities for automobile accident insurance and workmen's compensation claims in the accompanying statement of net assets.

The liability for compensation benefits is based on historical claims experience data, assumptions and projections as to future events, including claims frequency, severity, persistency, and inflationary trends determined by an independent actuary. The actuarial study also included estimates for medical benefits, benefit adjustment expenses, and reimbursement of premiums. The assumptions used in estimating and establishing the liabilities are reviewed annually based on current circumstances and any adjustments resulting thereof are reflected in operations in the current period.

### (e) *AACA*

AACA operates a system of compulsory insurance for vehicles licensed to be used on public roads and highways in Puerto Rico. This insurance covers death and bodily injuries caused by automobile accidents. The annual premium is \$35 per motor vehicle.



## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

The following table provides a reconciliation of the beginning and ending liability for the future benefits for the two most recent fiscal years (expressed in thousands):

	<u>2007</u>	<u>2006</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	\$ 114,388	107,817
Total incurred benefits	62,806	64,835
Total benefit payments	<u>(58,921)</u>	<u>(58,264)</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at end of year	<u>\$ 118,273</u>	<u>114,388</u>

The liability for future benefits is reported as liability for automobile accident insurance and workmen's compensation claims in the accompanying statement of net assets. AACA has recorded this liability, including administrative expenses for claim processing, based on the results of actuarial reports prepared by independent actuaries, determined under two different methods. Death, funeral, disability, dismemberment, and the basic medical hospitalization liabilities were determined using a triangulation method. The extended benefits medical hospitalization reserve uses a regression methodology to predict the ultimate incurred claims for each incurred calendar quarter. Additionally, assumptions are made about the mortality rates of the extended benefit claimants, recognizing the impact of their traumatic injuries on life span.

Changes in the ultimate liabilities for benefit payments may be required as information develops, which varies from experience, provides additional data, or, in some cases, augments data, which previously were not considered sufficient for use in determining the claim liabilities.

**(f) PRIFA**

PRIFA is responsible for assuring that its property is properly insured. Annually, PRIFA compiles the information of all property owned and its respective market value and purchases its property and casualty insurance policies. Insurance coverage for fiscal year 2007 remained similar to those of prior years. For the last three years, insurance settlements have not exceeded the amount of coverage.

**(18) Commitments and Contingencies**

***Primary Government***

The Commonwealth is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Commonwealth only for causes of actions set forth in said act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Commonwealth may provide its officers and employees with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgments.

## COMMONWEALTH OF PUERTO RICO

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With respect to pending and threatened litigation, excluding the litigation mentioned in the following paragraphs, the Commonwealth reported approximately \$400 million as an amount to cover for awarded and anticipated unfavorable judgments at June 30, 2007. This amount was included as other long-term liabilities in the accompanying statement of net assets, and represents the amount estimated as probable liability or a liability with a fixed or expected due date that will require future available financial resources for its payment. The amounts claimed exceed \$6 billion; however, the ultimate liability cannot be presently determined. It is the opinion of management that the claims are excessive and exaggerated. Management believes that the ultimate liability in excess of amounts provided, if any, would not be significant.

The Commonwealth is also a defendant in a lawsuit filed in a local district court by an association of primary care health centers seeking to recover from the Commonwealth \$800 million of Medicaid funds retained by the Department of Health of the Commonwealth since 1997. In June 2004, the First Circuit Court of San Juan determined that the Commonwealth must return these funds. The Commonwealth appealed this decision. As of June 30, 2007, the Commonwealth accrued \$50 million for this legal contingency.

The Commonwealth is a defendant in a class action presented by parents of special education students in the areas of education and healthcare. In October 2006, the San Juan Court of Appeals decided in favor of the parents' request to include damage claims pursuant to the same class action case although not as a remedy in the class action per se. The court now may award damages to the members of the class action and to do so it may look at the claims by dividing them into groups or consider each case individually. This will require that the parents prove the damages suffered. The Commonwealth plans to defend vigorously each individual case. As of June 30, 2007, the Commonwealth accrued \$450 million for this legal contingency.

The Commonwealth is a defendant in a lawsuit filed by a group of vehicle owners in the First Circuit Court of San Juan which questions the legitimacy of Act No. 42 of August 1, 2005, as amended. According to this Act, all luxury motor vehicles which are used for private purpose are obligated to pay additional annual fees for the use of the motor vehicle. On March 15, 2007, the First Circuit Court of San Juan ruled against the Commonwealth and ordered the Commonwealth to return the funds collected. The Commonwealth appealed this decision to the Court of Appeals. On January 29, 2008, the Court of Appeals upheld the decision of the First Circuit Court of San Juan. As of June 30, 2007, the Commonwealth accrued \$50 million for this legal contingency.

The Commonwealth receives financial assistance from the federal government in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal law and regulations, including the expenditure of resources for eligible purposes. Substantially, all grants are subject to audit under Circular A-133 of the Office of Management and Budget of the United States of America (OMB Circular A-133), all of which are performed at the individual department or agency level. Disallowance as a result of these audits may become liabilities of the Commonwealth. At June 30, 2007, based on an evaluation of pending federal disallowances, the Commonwealth has recorded approximately \$50 million as other long-term liabilities in the accompanying statement of net assets. Expenditures that are still subject to audit could be disallowed but management believes any such future disallowances would not be material to the basic financial statements.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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Construction commitments at June 30, 2007, entered by PBA, amounted to approximately \$238.9 million. In addition, the Commonwealth's construction commitments for public housing facilities amounted to approximately \$346.8 million at June 30, 2007.

On November 23, 1998, a global settlement agreement (the Agreement) was entered into by and between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies are to continue making contributions in perpetuity. Pursuant to Act No. 173 of July 30, 1999, which created the Children's Trust (a blended component unit), the Commonwealth assigned and transferred to the Trust all payments that the Commonwealth is entitled to receive under the agreement. Payments received under the agreement and recognized as revenue during the year ended June 30, 2007 amounted to approximately \$68.7 million.

Following is a summary of estimated payments to be received by the Trust through the year ending June 30, 2025 (expressed in thousands):

Year ending June 30:	
2008	\$ 78,679
2009	79,854
2010	80,913
2011	82,070
2012	83,225
2013-2017	432,723
2018-2022	518,021
2023-2025	328,129
Total	<u>\$ 1,683,614</u>

At June 30, 2007, the Trust had approved commitments to provide assistance to several entities through 58 contracts with balances amounting to approximately \$69.6 million.

#### ***Discretely Presented Component Units***

In the normal course of their operations, the various component units are subject to guarantees, actions brought by third parties seeking damages or entering into commitments. Such actions are disclosed in the separately issued reports of the components units, some of which are summarized below:

##### ***(a) GDB***

At June 30, 2007, GDB has financial guarantees for public entities for approximately \$125 million and for private sector of approximately \$128 million. In addition, standby letters of credit to public entities were approximately \$521 million and to private sector were approximately \$19 million. Commitments to extend credit to public entities were approximately \$14 million.

GDB enters into sales of securities under agreements to repurchase. These agreements generally represent short-term debts and are presented as a liability in the statement of net assets. The

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securities underlying these agreements are usually held by the broker, or its agent, with whom the agreement is transacted. As of June 30, 2007, there were agreements outstanding for \$455 million, and during the year, the average amount outstanding was approximately \$462 million, the maximum amount outstanding at any month-end was approximately \$544 million, and the weighted average interest rate for the year and at year-end was approximately 4.96% and 4.87%, respectively.

GDB issues commercial paper in the U.S. taxable and tax-exempt commercial paper markets, the Euro commercial paper market, and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act. Commercial paper represents unsecured obligations of GDB. The carrying amount of commercial paper at June 30, 2007 was approximately \$576 million.

At June 30, 2007, GDB had outstanding interest rate swap agreements with other financial institutions in the aggregate notional amounts of \$1.2 billion, having a fair value (payable position) of approximately \$29 million. GDB is exposed to credit loss in the event of nonperformance by counterparties.

During 2007, the Development Fund, a blended component unit of GDB, recorded an accrued legal contingency liability of \$10 million due to a legal claim for which the court has issued an adverse judgment. The claim was brought by a former industrial client to whom the Development Fund had approved a line of credit to enhance their production capabilities. However, due to noncompliance of client with the conditions of the commitment letter issued by the Development Fund, as well as uncertainties regarding the client's ability to repay the financial facility, the Development Fund was prompted to cancel the commitment letter. The client sued the Development Fund claiming it was responsible for losses sustained. The court held that claimant had incurred in significant expenses to increase their production based on the resources they expected to have available through the line of credit. Eventually, they had to cease their operations. Management has estimated the amount of the claim to be \$10 million based on consultation with its internal legal counsel. However, the ultimate liability is still pending court resolution and could differ from the estimated amount.

**(b) PRHTA**

PRHTA entered into a System and Test Track Turnkey Contract (STTT Contract) with Siemens Transportation Partnership Puerto Rico, S.E. (STT), Juan R. Requena y Asociados, and Alternate Concepts, Inc. (all together known as Siemens) for the purposes of operating and maintaining the urban train system known as the "Tren Urbano." The STTT Contract became effective during 2005 for an initial term of five years with an option by PRHTA to extend the term for an additional five years. The compensation is based on a schedule included in the master agreement, which approximates \$4 million on a monthly basis. The total annual operating and maintenance cost including cost of insurance and electricity for fiscal year 2007 was approximately \$51.3 million.

In connection with the responsibilities of the PRHTA for mass transportation systems, the Metrobus project was developed. The project consists of bus operations in part of the San Juan metropolitan area named Metrobus I, which operations are conducted by First Transit, a private company, under an agreement of \$5.8 million, which expired on June 30, 2007. In addition, the project consists of bus operations between Bayamón and Stop 18 named Metrobus II, which operations are conducted by the Metropolitan Bus Authority (MBA), a discretely presented component unit, under a 36-month

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agreement of \$13.5 million, which expired on June 30, 2007. During June 2003, January 2004, and July 2006, the PRHTA amended the MBA service contract for the purpose of adding certain additional routes to the mass transportation system. The amendment added to the original service contract the amount of \$53.1 million with a month-to-month term, which expired on June 30, 2007.

During December 2004, MBA entered into a contract agreement with PRHTA to integrate the Metrobus with the Tren Urbano mass transportation system. The total amount of this contract is approximately \$22.2 million and expired on June 30, 2007.

During 1995, MBA entered into a contract agreement with the PRHTA to operate and maintain one of Metrobus' routes from Río Piedras to Old San Juan, provide service for para-transit, and maintain the transfer stations. This contract is renewable every year with an increase of 6% over the last year's contract amount. The total amount of this contract is approximately \$1 million and expired on June 30, 2007.

Through Resolution 2007-40, the PRHTA renegotiated and combined all services contracts described above. The resolution established a total service contract amount payable to MBA in the amount of \$23.2 million, which will be payable on a monthly basis through June 30, 2008.

At June 30, 2007, PRHTA had outstanding interest rate swap agreements with other financial institutions in the aggregate notional amounts of \$589 million, having a fair value (net receivable position) of approximately \$1.2 million. PRHTA is exposed to credit loss in the event of nonperformance by the other parties to the swap agreements. However, PRHTA does not anticipate nonperformance by the counterparties.

On February 28, 2003, STT and other parties filed legal claims against PRHTA in the amount of approximately \$50 million for damages, amounts withheld, acceleration of work, and other causes of action in connection with the construction of the Tren Urbano. This claim was amended during 2005 to increase the amount to \$120 million. PRHTA has responded with several counter claims to STT and other contractors in the Tren Urbano project in amounts exceeding \$200 million.

On April 20, 2007, the administrative judge designated this case as a complex litigation and remitted it to the Chief Justice of the Supreme Court who has to assign a presiding judge for the case. The parties are still awaiting such designation. In the opinion of legal counsel, although discovery up to date has shown that it is unlikely that STT will prevail in its allegation against PRHTA, due to the complexities of the case, it is not possible to estimate the amount of any potential loss.

#### (c) **PREPA**

In October 1994, PREPA signed a contract with AES Puerto Rico, L.P. (AES) to purchase power of approximately 454 megawatts generated from a coal fluidized bed combustion facility. The term of the agreement is for 25 years. This project commenced operations in November 2002. In March 1995, the authority also signed a contract with EcoEléctrica, L.P. (EcoEléctrica) to purchase power of approximately 507 megawatts from a gas-fired combined cycle power plan. The term of the agreement is for 22 years. This project has been in operation since 2000.

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In May 1998, the Municipality of Ponce filed a complaint against PREPA in the San Juan Superior Supreme Court requesting the payment by PREPA of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years. The complaint challenges the application of the net revenues by the authority in making deposits to certain funds under the 1974 Agreement and under a prior trust indenture (now terminated) for the purposes of paying cost of capital improvement and seeks a payment by PREPA in the amount by which the amount available to pay contributions in lieu of taxes and electric energy sales set aside to the Municipality of Ponce has been reduced as a result of such application. PREPA understands that because the Act provided that the contributions in lieu of taxes and electric energy sales set aside are only payable after complying with the PREPA's deposit obligations under the 1974 Agreement and the prior indenture, and that shortfalls do not carry forward as future liabilities of PREPA as describe above, it is legally entitled to make such deposits even if the effect is to reduce such contributions and set aside available to municipalities.

On April 14, 2003, PREPA made a settlement offer consisting of a payment in cash of \$68 million and \$57 million for electric infrastructure projects in the municipalities. As part of the settlement agreement, the municipalities supported an amendment to the Act that was proposed by PREPA that the amount payable to municipalities be calculated based on a percentage of the net revenues defined on the 1974 Bond Indenture Agreement. Prior to fiscal year 2005, 76 of the 78 municipalities of Puerto Rico had accepted the settlement receiving an aggregate amount of \$63.6 million. During fiscal year 2005, the remaining municipalities accepted the settlement offer, receiving \$4.4 million. The settlement required PREPA to submit legislation to change the CLT calculation. The new law signed in August 2004 included a transition clause regarding the \$68 million payment, stating that this amount was a special CLT that the accepting municipalities would receive with financing provided by GDB. The debt to GDB is guaranteed with the CLT. In connection with the same litigation, GDB approved a line of credit of \$57 million, for electric infrastructure projects on municipalities. As of June 30, 2007, PREPA has drawn \$41.7 million.

In June 2004, the Office of the Comptroller of the Commonwealth of Puerto Rico (the Comptroller) issued a report stating that PREPA overcharged its clients by approximately \$49.8 million, and should reimburse this amount to such clients. After this report was made public, two lawsuits were filed by clients of PREPA demanding the reimbursement of such alleged overcharges. PREPA denies that any overcharges have been made.

On December 2006, two fires damaged one of the PREPA's generating units and the control room, which controls all four units located at Palo Seco plant. As a result, 602 megawatts of oil-fired capacity, representing 11% of the production plant installed; dependable capacity is not currently available. PREPA submitted claims to insurance companies of \$122.1 million, including the extra fuel expenses, and has received payments of \$5 million during the fiscal year ended June 30, 2007. In addition to the damages to the utility, plant, administrative, and general expenses charged to operations related to noncapitalizable activities amounted to \$8 million.

**(d) PRIFA**

The law that created PRIFA (as amended) requires that, in each fiscal year after fiscal year 2006 through fiscal year 2052, the first \$90 million of federal excise taxes received by the Commonwealth

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be transferred to PRIFA for deposit to PRIFA's infrastructure fund ( the Infrastructure Fund). These federal excise taxes consist of taxes received by the Commonwealth from the United States of America in connection with rum and other articles produced in Puerto Rico and sold in the United States of America that are subject to federal excise tax.

A related trust agreement requires PRIFA to deposit to the credit of a sinking fund the federal excise taxes and other moneys deposited to the credit of the Infrastructure Fund in such amounts as are required to meet debt service requirements with respect to certain related bonds. Rum is the only article currently produced in Puerto Rico subject to federal excise tax, the proceeds of which are required to be transferred from the federal government to the Commonwealth.

The federal excise taxes securing the bonds are subject to a number of factors, including the continued imposition and remittance of such taxes to the Commonwealth and conditions affecting the Puerto Rico rum industry. If the federal excise taxes received by the Commonwealth in any fiscal year are insufficient to deposit the amount required by the law into the Infrastructure Fund, the law that enacted PRIFA requires that PRIFA request the director of the OMB to include in the annual budget of the Commonwealth for the corresponding fiscal year an appropriation necessary to cover such deficiency. The Commonwealth's Legislature, however, is not legally obligated to make the necessary appropriation to cover such deficiency.

**(e) PRASA**

On June 29, 2007, PRASA entered into two forward interest rate swap agreements for the purpose of reducing the risk that an increase in long-term interest rates would have on the amount of money PRASA could borrow to implement its capital improvements program, at the time it is ready to issue its senior lien revenue bonds. The intention of the swaps is to effectively change the PRASA variable interest rate on the bonds to be issued on a future date to a synthetic fixed rate. The floating rate of these agreements will be based upon the Securities Industry and Financial Markets Association (SIFMA) municipal swap index. The aggregate notional amount under such agreements is \$930 million on the basis of the PRASA estimate regarding the total principal amount of senior lien, net revenue bonds expected to be issued by PRASA. The agreements evidencing these swaps permit PRASA to terminate them on or prior to the effective date of March 12, 2008, at the agreements' fair market value. The structure of the agreements is such that should long-term market interest rates increase from their date of execution to March 12, 2008, PRASA would receive a termination payment approximating the present value increase in borrowing costs on PRASA senior net revenue bonds, and should long-term market interest rates instead decrease, PRASA would be obligated to make a termination payment that approximates the decrease in such borrowing costs (similarly computed). It is expected that PRASA will execute its option to terminate the swaps at the time it issues the senior revenue bonds to finance a portion of its capital improvement program.

PRASA is defendant in a class action lawsuit presented by customers alleging that the PRASA has over billed them due to the methodology used to estimate consumption. The plaintiffs seek recovery of damages in the amount of \$175 million and an injunction enjoining PRASA from continuing to bill using the current methodology. PRASA's potential exposure from this class action lawsuit cannot be presently determined, and as such, no liability is being reported on the accompanying basic financing statements.

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**(f) PRTA**

PRTA, through its subsidiary PRTA Holdings, holds shares of Telecomunicaciones de Puerto Rico, Inc. (TELPRI), is the Puerto Rico corporation that was organized for the purpose of acquiring the stock of the Puerto Rico Telephone Company (PRTC) and Celulares Telefonica (CT) from PRTA in connection with the sale transaction of March 2, 1999, where a subsidiary of Verizon, Popular, Inc., and TELPRI's employee stock ownership plan acquired 57% of TELPRI and completed the privatization of PRTC and CT. It is contemplated that all shares of TELPRI held by PRTA Holdings will be sold in public offerings and private placements, and all dividends and proceeds received from the sale of the shares will be distributed to the ERS. The PRTA's 43% investment in TELPRI was carried on the equity method of accounting through December 28, 2000. Although the ownership of the common stock of PRTA Holdings entitles PRTA to the voting right over TELPRI shares, no carrying value is recorded for its investment after the transfer of PRTA Holdings' preferred stock to the Retirement System on December 28, 2000, since such preferred stock entitled the Retirement System to all the economic benefits of the investments in TELPRI.

On March 31, 2000, Verizon delivered notice of claim for indemnity to PRTA related to certain alleged actions of PRTA that occurred before the closing of the purchase transaction describe above. The amount of indemnity sought by Verizon is approximately \$105 million, related to several matters including PRTC's exposure to a potential reduction in tariffs or required rebate to clients as a result of an adverse decision by the Federal Communications Commission (FCC) on a regulatory matter. The FCC's decision has been appealed by PRTC and FCC denied such request. In June 2000, PRTA requested Verizon to provide additional information that would enable it to evaluate the merit of claims made, but to date, the additional information has not been submitted.

Management believes that the final resolution of the legal cases will not have a material adverse effect on the financial position and results of operations of PRTA.

**(g) LAPR**

At year-end, LAPR had approximately \$28.2 million in accruals to cover the estimated costs related to the liquidation of the Sugar Corporation of Puerto Rico, a blended component unit of LAPR, including, among others: employee severance, pending legal cases, environmental cleanup costs, refinery repair costs, and estimated future losses to be incurred. Management believes these accruals to be sufficient; however, given the many uncertainties involved, the ultimate outcome cannot be determined with certainty at this time, and the actual liquidation costs could be higher or lower than the estimates made. LAPR is also a defendant in various claims amounting to approximately \$138.3 million. LAPR is in the process of litigating such claims and the ultimate liability, if any, cannot be presently determined.

**(h) PCSDIPRC**

PCSDIPRC provides insurance coverage over the stocks and deposits of all the cooperatives and the Federation of Cooperatives of Puerto Rico. The deposit base of the cooperatives approximates \$6 billion at June 30, 2007.



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#### **Fiduciary Component Unit**

On June 29, 2007, ERS executed the repurchase agreement with the counterparty, liquidating the liability associated with this transaction and liberating the associated collateral, using the sales proceeds of the investment in PRTA Holdings.

As of June 30, 2007, ERS entered into various contracts with outside contractors for construction and remodeling the building facilities. ERS records the liability for these contracts as progress billings are received, based on completed work. The uncompleted portion of these contracts approximated \$2 million as of June 30, 2007.

#### **Environmental Commitments and Contingencies**

The following component units' operations include activities that are subject to state and federal environmental regulations:

- **PREPA** – Facilities and operations of PREPA are subject to regulations under numerous federal and commonwealth environmental laws, including the Clean Air Act, Clean Water Act, and the National Pollutant Discharge Elimination System (NPDES). In February 1992, the Environmental Protection Act (EPA) performed an inspection of various facilities of PREPA and became aware of deficiencies in different areas, principally air opacity; water quality; spill prevention control and countermeasures; and underground storage tanks. As result, PREPA agreed to, among other things, make certain capital improvements, undertake supplemental environment projects, and use fuel oil not exceeding certain predetermined levels of sulfur, vanadium, and asphalt in its content.
- **PRSWA** – PRSWA is currently involved in the implementation and development of the Infrastructure Regional Plan for recycling and disposal of solid waste in Puerto Rico. As of June 30, 2007, PRSWA believes that there is no sufficient information available to determine the potential amount of related losses, if any, and no provision for losses has been made to the financial statement. Nevertheless, preventive infrastructure has been constructed to minimize any possible impact or events that occur. In addition, operational plans have been developed to incorporate good maintenance practices.
- **PRIDCO** – Financial responsibility for cleanup costs has been and/or are being undertaken by the industrial potentially responsible parties (PRPs) at the two Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) sites (Vega Alta and Guayama) where the federal government named PRIDCO as a PRP solely for being a part-owner of both sites. Under CERCLA and its regulations, liability for the cleanup cost and damage to natural resources and any assessment of health effects may be imposed on the present and past owners or operators of a facility from which there was a release of hazardous substances. In addition, any person who arranged for the disposal or treatment of hazardous substances at a site from which there was a release may also be liable. The resolution of those legal actions included various environmental issues to which PRIDCO did not stipulate liability under the CERCLA and other federal legislation. CERCLA establishes procedures and standards for responding to the release of hazardous substances, pollutants, and contaminants.

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### Construction Commitments

As of June 30, 2007, the following component units maintained various unspent construction agreements as follows (expressed in thousands):

Puerto Rico Highways and Transportation Authority	\$	762,050
Puerto Rico Electrical Power Authority		475,000
Puerto Rico Aqueduct and Sewer Authority		404,000
Special Communities Perpetual Trust		348,060
University of Puerto Rico		160,305
Puerto Rico Solid Waste Authority		110,722
Puerto Rico Ports Authority		80,042
Puerto Rico Medical Services Authority Administration		52,058
Puerto Rico Infrastructure Financing Authority		35,306
Puerto Rico Conservatory of Music Corporation		17,942
Puerto Rico Trade and Export Company		12,365
Institute of Puerto Rican Culture		10,552
Puerto Rico Industrial Development Company		10,375
Fine Arts Center Corporation		808
Cardiovascular Center Corporation of Puerto Rico and the Caribbean		567
Institutional Trust of the National Guard of Puerto Rico		440
Total	\$	<u>2,480,592</u>

### (19) Retirement Systems

The Commonwealth sponsors three contributory pension plans (collectively known as the Retirement Systems), which are reported in the accompanying statement of fiduciary net assets:

- Employees' Retirement System of the Government of Puerto Rico and its instrumentalities (ERS)
- The Puerto Rico Judiciary Retirement System (JRS)
- Puerto Rico System of Annuities and Pensions for Teachers (TRS)

Each system is independent; thus, their assets or liabilities may not be transferred from one system to another or used for any purpose other than to benefit the participants of each system.

The Retirement Systems issue financial reports, which are publicly available and include the basic financial statements, the required trend information, and any other required supplementary information. These reports may be obtained by written request to the corresponding retirement system administrator at the addresses detailed in note 1 of each retirement system's basic financial statements.

#### (a) *ERS*

##### Plan Description

The System is a cost-sharing multi-employer defined-benefit plan sponsored by the Commonwealth. ERS was created under Act No. 447 (the Act), approved on May 15, 1951, as amended, and became

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effective on January 1, 1952. ERS covers substantially all full-time employees of: (1) the Commonwealth's primary government and (2) certain municipalities of Puerto Rico and certain component units of the Commonwealth not having their own retirement systems. Appointed and temporary commonwealth employees become plan members upon their date of employment. Plan members are eligible for a retirement annuity upon reaching the following age:

<b>Police and firemen</b>	<b>Other employees</b>
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

Plan members are eligible for merit annuity with a minimum of 30 years or more of credited service.

On the coordinated plan, a participating employee contributes 5.775% of the monthly salary for the first \$550 and 8.275% for the excess over \$550. By the time the employee reaches 65 years of age and begins to receive social security benefits, the pension benefits are reduced by the following:

- \$165 per month if retired with 55 years of age and 30 years of credited service
- \$110 per month if retired with less than 55 years of age and 30 years of credited service
- All other between \$82 and \$100 per month
- Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases are reduced over \$165 per month.

On the noncoordinated plan, the participating employee contributes 8.275% of the monthly salary and does not have any change on the pension benefits upon receipt of social security benefits.

Death benefits are divided into occupational, nonoccupational, and postretirement. Under the occupational benefits, a surviving spouse may receive an annuity equal to 50% of the participating employee's salary at the date of death and each child may receive \$10 per month for minor, or student, up to a maximum benefit per family of 100% of the participating employee's salary at the date of death. If no spouse survives, or dies while receiving the annuity payments, each child, 18 or under, is eligible to receive an annuity of \$20 per month up to the attainment of 18 years of age or the completion of his/her studies. Under the nonoccupational benefits, the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of death are paid. Under the postretirement benefits, the beneficiary with a surviving spouse and child 18 or under receive up to 50% (60%, if not covered under Title II of the Social Security Act) of the retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

On September 24, 1999, an amendment to the Act, which created ERS, was enacted to establish a defined-contribution plan known as System 2000.

System 2000 became effective on January 1, 2000. Employees participating in the defined-benefit plan system at December 31, 1999 had the option to either stay in the defined-benefit plan or transfer

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to System 2000. Persons employed on or after January 1, 2000 are only allowed to become members of System 2000.

System 2000 is a hybrid defined-contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of plan assets, which will be invested by ERS, together with those of the defined-benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on a formula that assumes that each year the participants' contributions (with a minimum of 8.275% of the participants' salary up to a maximum of 10%) will be invested as instructed by the participant in an account, which will: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Notes; (2) earn a rate equal to 75% of the return of ERS's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined-contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The sponsors' contributions (9.275% of the participants' salary) will be used to fund the defined benefit plan.

System 2000 reduces the retirement age from 65 years to 60 for those employees who joined the original plan on or after January 1, 2000.

#### **Funding Policy**

Contribution requirements, which are established by law and are not actuarially determined, are as follows:

Commonwealth and other sponsors	9.275% of applicable payroll
Participants:	
Hired on or before March 31, 1990	5.775% of monthly gross salary up to \$550 8.275% of monthly gross salary in excess of \$550
Hired on or after April 1, 1990	8.275% of monthly gross salary

#### **(b) JRS**

##### **Plan Description**

The JRS is a single-employer defined-benefit plan, which is also administered by the ERS. The system was created under Act No. 12, approved on October 19, 1954. Membership is made up of all judges of the Judiciary Branch of the Commonwealth.

The system provides retirement as well as death and disability benefits. Benefits vest after 10 years of service and upon reaching 60 years of age.

Retirement benefits are determined by the application of stipulated benefit ratios to the plan member's average compensation. Average compensation is computed based on the last month of compensation.

The retirement annuity, for which the plan participant is eligible, is limited to a minimum of 25% and a maximum of 75% of the average compensation, except for judges of the Supreme Court for

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whom the annuity is limited to a minimum of 50% and a maximum of 100% of the average compensation.

Death benefits are divided into occupational, nonoccupational, and postretirement. Under the occupational benefits, a surviving spouse may receive an annuity equal to 50% of the participating employee's salary at the date of death and each child may receive \$10 per month for each child, minor, or student, up to a maximum benefit per family of 75% of the participating employee's salary at the date of death. If no spouse survives or dies while receiving the annuity payments, each child, 18 or under, is eligible to receive an annuity of \$20 per month up to the attainment of 18 years of age or the completion of his/her studies. Under the nonoccupational benefits, the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of death is paid. Under the postretirement benefits, the beneficiary with surviving spouse age 60 or over and child age 21 or under will receive up to 60% of the retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$500.

During 1997, JRS enacted Act No. 177 that provides, effective January 1, 1999, for increases of 3%, every three years, of the pension benefits paid by JRS to those plan participants with three or more years of retirement.

#### **Funding Policy**

All participants are required to make contributions to the plan equal to 8% of the applicable payroll. The Commonwealth, as sponsor, must contribute 20% of the applicable payroll. Contributions are established by law and are not actuarially determined.

#### **(c) TRS**

##### **Plan Description**

The TRS is a single-employer defined-benefit plan sponsored by the Commonwealth. All active teachers of the Department of Education of the Commonwealth are covered by the system under the terms of Act No. 91 of March 29, 2004 that superseded Act No. 218 of 1951. Licensed teachers working in private schools may also participate in the system as long as the required employer and employee contributions are satisfied.

The plan provides retirement, death, and disability benefits. Benefits vest after completion of a given number of years of credited service based on age. Benefits are determined by the application of stipulated benefit ratios to the members' average compensation. Average compensation is computed based on the highest three years of compensation recognized by TRS.

The annuity for which a plan member is eligible is limited to a minimum of \$300 per month and a maximum of 75% of the average compensation.

##### **Funding Policy**

Effective January 27, 2000, participant contributions were increased to 9% of their compensation, as provided by Act No. 45 of 2000. The Commonwealth, as sponsor, matches the participants'

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contributions at a rate of 8.5% of the applicable payroll. Contribution rates are established by law and are not actuarially determined.

Other relevant information on the Commonwealth's Retirement Systems is presented below (as of July 1, 2005, for JRS and ERS, and July 1, 2007 for TRS, for latest valuation date):

### *Membership*

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>	<u>Total</u>
Retirees and beneficiaries currently receiving benefits	99,851	367	28,966	129,184
Current participating employees	<u>107,256</u>	<u>370</u>	<u>48,505</u>	<u>156,131</u>
Total	<u><u>207,107</u></u>	<u><u>737</u></u>	<u><u>77,471</u></u>	<u><u>285,315</u></u>

### *Annual Pension Cost and Net Pension Obligation (Asset)*

The Commonwealth's annual pension cost and net pension obligation (asset) of the three pension plans for the year ended June 30, 2007 were as follows (expressed in thousands):

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>	<u>Total</u>
Annual required contributions	\$ 564,217	9,735	341,160	915,112
Interest on net pension obligation (asset)	332,802	(859)	64,790	396,733
Adjustment to annual required sponsors' contributions	<u>(262,137)</u>	<u>677</u>	<u>(50,543)</u>	<u>(312,003)</u>
Annual pension cost	634,882	9,553	355,407	999,842
Statutory sponsors' contributions made	<u>(460,491)</u>	<u>(6,632)</u>	<u>(174,280)</u>	<u>(641,403)</u>
Increase in net pension obligation	174,391	2,921	181,127	358,439
Net pension obligation (asset) at beginning of year	<u>4,135,143</u>	<u>(7,285)</u>	<u>605,663</u>	<u>4,733,521</u>
Net pension obligation (asset) at end of year	<u><u>\$ 4,309,534</u></u>	<u><u>(4,364)</u></u>	<u><u>786,790</u></u>	<u><u>5,091,960</u></u>

The net pension obligation for ERS and TRS, and the net pension asset of JRS of \$5,096 million and \$4 million, respectively, are recorded in the accompanying statement of net assets.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

The annual required contribution was determined by actuarial valuations for each of the pension plans as described below:

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>
Date of latest actuarial valuation	July 1, 2005	July 1, 2005	July 1, 2007
Actuarial-cost method	Projected unit credit cost	Projected unit credit cost	Entry age normal
Amortization method	Level percentage of the projected payroll	Level percentage of the projected payroll	Level percentage closed 5% payroll increase per year
Remaining amortization period	21 years	21 years	16 years
Amortization approach	Closed	Closed	Closed
	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>
Asset-valuation method	Market value	Market value	Market value
Actuarial assumptions:			
Inflation	3.5%	3.5%	3.5%
Investment rate of return	8.5	8.5	8.5
Projected salary increases per annum	5.0	5.0	5.0
Cost-of-living adjustments	None	None	None

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

### Three-Year Trend Information

The three-year trend information is as follows (expressed in thousands):

	ERS	JRS	TRS
Annual pension cost (APC):			
Year ended June 30, 2007	\$ 634,882	9,553	355,407
Year ended June 30, 2006	634,882	9,553	221,449
Year ended June 30, 2005	652,252	8,380	221,449
Percentage of APC contributed:			
Year ended June 30, 2007	72.5%	69.4%	49.0%
Year ended June 30, 2006	65.0	70.0	81.0
Year ended June 30, 2005	60.0	77.0	82.0
Net pension obligation (asset):			
Year ended June 30, 2007	\$ 4,309,534	(4,364)	786,790
Year ended June 30, 2006	4,135,141	(7,285)	605,663
Year ended June 30, 2005	3,915,315	(10,111)	564,480

### Schedule of Funding Progress (Required Supplementary Information – Unaudited)

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (expressed in thousands):

Actuarial valuation date	Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
July 1, 2005	\$ 2,327,871	12,283,865	9,955,994	19%	\$ 4,125,866	241%
July 1, 2004	2,141,442	N/A	N/A	N/A	N/A	N/A
July 1, 2003	1,947,402	11,191,357	9,243,955	17	3,334,441	277

The Puerto Rico Judiciary Retirement System (expressed in thousands):

Actuarial valuation date	Actuarial value of assets	AAL	UAAL	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
July 1, 2005	\$ 69,797	174,454	104,657	40%	\$ 29,331	357%
July 1, 2004	67,851	N/A	N/A	N/A	N/A	N/A
July 1, 2003	61,781	166,732	104,951	37	25,711	408



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

Puerto Rico System of Annuities and Pensions for Teachers (expressed in thousands):

Actuarial valuation date	Actuarial value of assets	AAL	UAAL	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
July 1, 2007	\$ 3,163,000	7,756,000	4,593,000	41%	1,370,000	33.5%
July 1, 2004	2,403,000	4,702,000	2,299,000	51	1,294,000	178
July 1, 2003	2,143,000	4,540,000	2,397,000	47	1,195,000	201

On August 12, 2000, Act No. 174 was approved to allow certain ERS participants to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75% (if 25 or more years of service and age 55, or 30 or more years of service and age 50) or benefits of 65% (if 25 years of service by less than age 55) of their average compensation, which is computed based on the highest 36 months of compensation recognized by ERS. In these cases, the sponsor is responsible for contributing to ERS amounts to cover the benefit payments and the sponsor contribution with respect to the participants covered until the participants reach the normal retirement age.

## (20) Subsequent Events

### *Primary Government*

On September 19, 2007 the Commonwealth issued Public Improvement Bonds of 2007, Series A amounting to \$408.8 million and Public Improvement Bonds of 2007, Series B amounting to \$91.2 million. The net proceeds will be used to carry out certain capital improvements programs authorized by the law. The bonds are payable through 2034 and bear annual interest rates ranging between 5.00% and 5.25%.

On October 18, 2007, the Commonwealth issued tax and revenue anticipation notes amounting to \$1,010 million for the purpose of funding a portion of the projected cash flow requirements of the general fund in fiscal year 2008, which requirements result from timing differences between expected disbursements and receipts of taxes and other revenue. The notes are due on July 30, 2008 and bear an annual interest rate of 4.25%.

On May 7, 2008, the Commonwealth issued its \$1,099 million Public Improvement Refunding Bonds, Series 2008 A, 2008 B and 2008 C. These bonds were issued for the purpose of (i) reducing the Commonwealth's market risk associated with certain types of variable rate products, including auction rate securities and variable rate demand obligations insured by monoline bond insurers that have recently been downgraded by the rating agencies, and (ii) realizing debt service savings. The bonds are payable through 2032 and bear annual interest rates ranging between 4.00% and 5.63%.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

#### *Component Units*

##### *(a) PREPA*

On September 13, 2007, PREPA and GDB entered into an agreement for a line of credit of \$100 million to be used in the recovery of the Palo Seco Plant from fire damages sustained during December 2006. On December 19, 2007, PREPA and a commercial bank entered into an agreement for a line of credit of \$100 million to be used also for the recovery of the Palo Seco Plant. For the seven-month period ended January 31, 2008, PREPA received \$69.4 million from insurance companies related to its Palo Seco Plant claim for the fire damage recovery.

On September 5, 2007, PREPA entered into an interest-rate swap transaction with UBS AG and Goldman Sachs Capital Markets for two-third and one-third, respectively, of a notional amount of \$600 million in bonds to be issued by PREPA. The transaction will expire on September 1, 2008, or the date before the bonds will be issued, if earlier than September 1, 2008. The transaction fixed rate was established at 3.652% per annum. The interest-rate swap transaction is subject to the terms and conditions of an ISDA Master Agreement entered between PREPA and UBS AG on April 18, 2007, and on September 5, 2007 with Goldman Sachs Capital Markets.

On January 30, 2008, PREPA and Bank of America entered into an agreement for line of credit of \$50 million to be used for financing fuel purchases.

##### *(b) PRASA*

On September 27, 2007, PRASA issued \$39.1 million of Series EE of USDA Rural Development Program Bonds, at 4.25% of interest, payable semiannually and maturing in semiannually installments through July 1, 2047. The funds raised by this issuance were used to partially repay the outstanding balance of USDA Rural Development Program lines of credit for construction projects from GDB. The payment of principal and interest on these bonds is guaranteed by the Commonwealth.

On February 14, 2008, PRASA terminated its two forward interest rate swap agreements entered into on June 29, 2007, and is obligated to make a termination payment of approximately \$75 million to the holders of the agreements. PRASA funded the termination payment from the proceeds of a revenue bond issuance that occurred on March 2008, as described below. PRASA will report additional interest expense of approximately \$75 million during the year ended June 30, 2008 related to the termination payment.

On March 7, 2008, PRASA issued \$1,316.2 million of 2008 Series A Revenue Bonds and \$22.4 million of 2008 Series B Revenue Bonds to pay a portion of the cost of its capital improvement program and to refinance certain outstanding bond anticipation notes and lines of credit. On March 7, 2008, PRASA also issued \$159.1 million 2008 of Series A Revenue Refunding Bonds and \$125.7 million of 2008 Series B Revenue Refunding Bond that are both guaranteed by the Commonwealth for the refinancing of its Commonwealth-guaranteed 1995 Series Revenue Refunding Bonds.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

**(c) PRIFA**

On October 25, 2007, the Authority issued \$43.3 million in revenue bonds for the purpose of repaying the term loan agreement entered into by PRIFA with GDB for \$34.2 million related to the acquisition of certain medical facilities.

**(d) PRHIA**

On October 2007, PRHIA entered into a contract with the Municipality of Guaynabo (the Municipality) with 13,592 covered lives. Under this contract, the Municipality bears the risk of the basic and special coverage and PRHIA bears the risk of dental and mental coverage. A third-party administrator handles all the administrative work related to the payment of claims for the services provided outside the Municipality's facilities. As a result of this arrangement, PRHIA no longer receives the contribution portion of the Municipality.

**(e) COFINA**

On July 31, 2007, COFINA issued \$2,668 million 2007 Series A bonds, and \$1,333 million 2007 Series B bonds for the payment and retirement of a portion of the extra-constitutional debt owed to GDB and PFC, which was outstanding as of June 30, 2007. GDB received \$1.7 billion in partial payment of the \$2.8 billion of its public sector loans considered extra constitutional debt.

***Fiduciary Funds***

On January 29, 2008 and May 28, 2008 ERS issued senior pension funding bonds amounting to \$1,589 million and \$1,059 million respectively to increase funds currently available to pay benefits and reduce its unfunded accrued actuarial pension liability. The bonds are payable through 2058 and bear annual interest rates ranging between 5.85% and 6.45%

**(21) Debt Service Deposit Agreements**

On May 26, 2005 (but effective on July 1, 2005), the Commonwealth, PFC, and GDB (together the Commonwealth) and Lehman Brothers Special Financing Inc. (Lehman) entered into Debt Service Deposit Agreements (DSD Agreements), the objective of which was for the Commonwealth to secure an upfront payment in exchange for granting Lehman the rights to earnings generated from eight of its debt service funds. Seven of the funds are associated with the commonwealth's PFC bonds, presented in the accompanying basic financial statements as commonwealth appropriation bonds, and one fund is associated with the Commonwealth's general obligation bonds. The upfront payment, which amounted to \$82.7 million, was received on May 26, 2005 and equaled the present value of the projected earnings income adjusted for credit timing risks as well as an appropriate amount of compensation for Lehman.

With the upfront payment made as explained above, the Commonwealth delivers to Lehman the required and scheduled debt service deposits and Lehman delivers qualified government debentures, which will mature before the next debt service payment date at an amount approximating such next debt service payment. Lehman will attempt to earn sufficient funds on the debt service deposit amounts, less its cost for the qualified government debentures, to make back the \$82.7 million over time. At the same time, the Commonwealth will be managing its borrowings and investments by increasing the predictability of its cash flows from earnings on its investments and not for purpose of speculation. The Commonwealth

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2007

acknowledges that, in exchange for the upfront payment received, it is foregoing its right to receive investment earnings on the deposit amounts referred to above in the future and that, by accepting the upfront payment, the Commonwealth has minimized the risks resulting from fluctuations in interest rates during the term of the DSD Agreements but also has foregone the possibility of receiving greater returns on such amounts from such fluctuations.

Under the DSD Agreements, the Commonwealth will be exposed to the payment to Lehman of a Termination Amount, as defined in the agreement, principally upon the occurrence of redemption or a defeasance of the related bonds on or prior to the last scheduled deposit date. The amount of the Termination Amount will vary depending on various market conditions, as defined in the DSD Agreements. Under certain market conditions, the Termination Amount owed to Lehman by the Commonwealth may exceed the amount of the original upfront payment received.

The \$82.7 million upfront payment received by the Commonwealth was recognized as other revenue for budgetary purposes in 2005; however, under U.S. generally accepted accounting principles, such upfront payment was deferred and is being recognized proportionally over the future periods the Commonwealth would have otherwise earned such interest earnings. As the effective date of DSD Agreements was July 1, 2005, all of the \$82.7 million upfront payment received in 2005 had been recorded as deferred revenue. During fiscal year 2007, approximately \$6.5 million was amortized into other revenue in the accompanying statement of activities.

### (22) Derivatives

As of June 30, 2007, the Commonwealth was party to the following interest-rate swap agreements (notional amount and fair value in thousands):

Date	Notional amount	Floating rate indicator (pays)	June 30, 2007				Maturity date	Fair value June 30, 2007
			Receives		Pays			
			Type	Rate	Type	Rate		
April 13, 2004	\$ 51,600	LIBOR	Fixed	3.3080%	Variable	0.2500%	May 27, 2021	\$ 1,076
April 13, 2004	56,000	LIBOR	Fixed	3.5820	Variable	3.4313%	June 27, 2024	412
April 13, 2004	56,000	LIBOR	Fixed	3.5590	Variable	3.3415%	June 29, 2027	(535)
April 13, 2004	55,975	LIBOR	Fixed	3.5750	Variable	3.3415%	June 29, 2028	(595)
April 13, 2004	19,290	LIBOR	Fixed	3.5700	Variable	3.3415%	June 29, 2029	(185)
April 13, 2004	30,710	LIBOR	Fixed	3.5700	Variable	3.3415%	June 29, 2029	(297)
April 13, 2004	50,000	LIBOR	Fixed	3.5730	Variable	3.3415%	June 29, 2029	(496)
April 13, 2004	61,975	LIBOR	Fixed	3.5740	Variable	3.3415%	June 29, 2029	(582)
April 13, 2004	62,000	LIBOR	Fixed	3.5090	Variable	3.2883%	June 29, 2029	(395)
June 21, 2006	1,273,778	3 m LIBOR	3 m LIBOR X .67	3.0820	BMA	3.7300%	July 1, 2035	13,475
		BMA	Fixed	0.0441	N/A	N/A	N/A	4,492
August 10,2006	30,005	N/A	CPI +0.98	2.2850	Fixed	4.26	July 1, 2018	(1,495)
August 10,2006	31,280	N/A	CPI +1.00	2.3050	Fixed	4.29	July 1, 2019	(1,560)
August 10,2006	32,625	N/A	CPI +1.02	2.3250	Fixed	4.32	July 1, 2020	(1,629)
August 10,2006	32,815	N/A	CPI +0.90	2.2050	Fixed	4.20	July 1, 2021	(1,639)
	\$ 1,844,053							10,047

The purpose of the interest rate agreements issued on April 13, 2004 in the notional amount of \$448 million was to hedge the Commonwealth's variable rate debt exposure and the interest rate risks associated therewith in relation to the Puerto Rico Public Improvement Refunding Bonds, Series 2004 B.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2007

On June 21, 2006 (with effective date of July 1, 2006), the Commonwealth entered into a basis swap agreement in the notional amount of \$1.3 billion with an amortization schedule matching the long-term maturities of outstanding general obligation and refunding bonds issued in various years from 1998 to 2005. Additional-basis swap agreements are expected to cover the 2006 General Obligation Bonds awaiting issuance. Under the terms of a master swap agreement, the Commonwealth will pay quarterly commencing on October 1, 2006 a floating rate equal to the tax-exempt Bond Market Association (BMA) index in exchange for receiving a floating rate equal to 67% of the taxable LIBOR index reset each week and a fixed rate payment of 0.4409% per annum, quarterly for the term of swaps. This basis swap provides the Commonwealth the cash flow benefit of the basis annuity in exchange for the Commonwealth taking tax and other basis risks similar to the risks taken in its outstanding LIBOR-hedged synthetic fixed rate Public Refunding Bonds, Series 2004 described above.

On August 2, 2006 (with effective date of August 10, 2006), the Commonwealth entered into an interest rate swap agreement in the notional amount of \$126.7 million. Said agreement is in connection with the issuance of the Public Improvement Bonds of 2006, Series A, subject to bear interest at the Consumer Price Index (CPI) rate. Through this agreement, the Commonwealth is required to pay a fixed interest rate and is entitled to receive a floating interest rate equal to the CPI rate, each based on a notional amount equal to the principal amount of the CPI bonds.

By using derivative financial instruments to hedge the exposure to changes in interest rates, the Commonwealth exposes itself to credit risk, market-access risk, and basis risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Commonwealth, which creates a credit risk for the Commonwealth. When the fair value of the derivative contract is negative, the Commonwealth owes to the counterparty and, therefore, does not possess credit risk. The Commonwealth minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties whose credit rating is acceptable under the investment policies of the Commonwealth.

Market risk is the adverse effect on the value of a financial statement instrument that results from a change in interest rates. The market risk associated with an interest rate swap contract is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. The Commonwealth assesses interest rate cash flows risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected cash flows and evaluating hedging opportunities. The Commonwealth maintains risk management control systems to monitor interest rate cash flow risk attributable to both the Commonwealth outstanding or forecasted debt obligations as well as the Commonwealth offsetting hedge positions.

Basis risk arises when different indexes are used in connection with a derivative. The 2006 swap exposes the government to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. If a change occurs that results in the rates moving to convergence, the expected cost savings may not be realized. The Commonwealth assesses basis risk by following the aforementioned market risks control system.

**COMBINING, INDIVIDUAL FUND  
FINANCIAL STATEMENTS AND SCHEDULES**

## **GENERAL FUND**

The general fund is the primary operating fund of the Commonwealth. The general fund is used to account for resources traditionally associated with government, which are not required legally or by sound financial management to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, education, and economic development. Following is the supplemental schedule of expenditures – budget and actual – general fund.

**COMMONWEALTH OF PUERTO RICO**

Supplemental Schedule of Expenditures by Agency – Budget and Actual –  
Statutory Basis – General Fund

Year ended June 30, 2007

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Expenditures:				
Current:				
General government				
Senate of Puerto Rico	\$ 33,599	33,219	33,219	—
House of Representatives of Puerto Rico	44,422	44,422	45,358	(936)
Comptroller's Office	41,733	41,733	42,005	(272)
Governor's Office	5,104	4,648	4,157	491
Office of Management and Budget	42,837	42,990	36,910	6,080
Planning Board	16,146	15,838	14,138	1,700
Constructions and Land Subdivisions Appeals Board	1,409	1,401	1,260	141
Department of State	7,679	7,658	7,658	—
Department of the Treasury	162,568	166,444	164,137	2,307
Central Office of Personnel Administration	7,321	7,306	7,078	228
Commonwealth Elections Commission	33,816	34,273	37,735	(3,462)
Federal Affairs Administration	6,255	6,255	6,034	221
General Services Administration	572	601	559	42
Municipal Complaints Hearing Commission	4,587	5,460	4,613	847
Civil Rights Commission	867	867	868	(1)
Office of the Citizen's Ombudsman	5,049	5,000	4,992	8
Appellate Board of the Personnel System Administration	1,708	1,705	1,612	93
Rules and Permits Administration	6,281	6,275	5,696	579
Commonwealth's Commission to Settle Municipal Complaints	185	180	179	1
Legislative Affairs Office	975	775	525	250
Commission for the Public Service Work Relations	2,287	2,233	2,004	229
Government Ethics Board	9,890	9,890	9,890	—
Legislative Affairs Office	7,258	7,763	7,457	306
Office of the Superintendent of the Capitol	10,022	10,022	10,032	(10)
Comptroller's Special Reports Joint Commission	636	636	636	—
Legislative Donation Commission	671	746	670	76
Coordination Office for Special Communities of Puerto Rico	8,900	9,090	8,916	174
Public Affairs	4,230	4,230	3,807	423
Governor's Secretary Office	9,384	9,316	9,240	76
Total general government	<u>476,391</u>	<u>480,976</u>	<u>471,385</u>	<u>9,591</u>
Public safety				
Puerto Rico General Court of Justice	313,103	313,171	321,514	(8,343)
State Civil Defense Agency	—	328	328	—
Commission of Investigation, Processing and Appeals Board	676	671	671	—
Department of Justice	142,924	144,230	134,739	9,491
Puerto Rico Police Department	839,757	849,785	840,798	8,987
Puerto Rico Firefighters Corps	69,777	69,328	64,013	5,315
Puerto Rico National Guard	8,247	8,680	8,680	—
Public Service Commission	12,286	12,284	11,265	1,019
Consumer Affairs Department	13,558	13,506	12,013	1,493
Juvenile Institutions Administration	90,014	91,847	92,100	(253)
Corrections Administration	377,757	377,045	374,921	2,124
Natural Resources Administration	44,494	49,193	44,743	4,450
Department of Correction and Rehabilitation	4,602	4,766	4,766	—
Parole Board	2,879	2,796	2,546	250
Forensic Sciences Institute	15,325	15,325	14,653	672
Special Prosecutor Panel	1,925	1,925	1,925	—
Pre-Trial Services Office	7,422	7,421	6,884	537
Correctional Health	81,282	81,279	85,083	(3,804)
Criminal Justice College	7,323	7,323	6,591	732
Medical Emergencies Service	26,060	26,167	25,667	500
Total public safety	<u>2,059,411</u>	<u>2,077,070</u>	<u>2,053,900</u>	<u>23,170</u>
Health				
Environmental Quality Board	12,308	13,018	12,021	997
Department of Health	299,339	303,074	265,273	37,801
Mental Health and Drug Addiction Services Administration	121,291	159,678	122,160	37,518
Puerto Rico Medical Service Administration	1,700	1,700	51,700	(50,000)
Solid Waste Authority of Puerto Rico	4,624	4,624	4,385	239
Puerto Rico Health Insurance Administration	989,386	950,611	1,124,905	(174,294)
Total health	<u>1,428,648</u>	<u>1,432,705</u>	<u>1,580,444</u>	<u>(147,739)</u>



**COMMONWEALTH OF PUERTO RICO**

Supplemental Schedule of Expenditures by Agency – Budget and Actual –  
Statutory Basis – General Fund

Year ended June 30, 2007

(In thousands)

	Original budget	Amended budget	Actual	Variance
Public housing and welfare				
Rural Housing Administration	—	—	1,298	(1,298)
Office of Youth Affairs	6,919	6,864	6,427	437
Puerto Rico Volunteers Service Corps	9,830	10,925	10,425	500
Department of Labor and Human Resources	2,041	2,021	1,825	196
Labor Relations Board	994	994	960	34
Department of Housing	25,726	26,902	24,329	2,573
Department of Recreation and Sports	51,991	53,047	49,394	3,653
Administration for the Horse Racing Sport and Industry	4,007	4,535	4,183	352
Women's Affairs Commission	5,331	5,231	4,468	763
Office of the Veteran's Ombudsman	3,245	3,244	3,132	112
Department of Family	54,808	55,027	51,726	3,301
Family and Children Administration	150,715	150,665	144,728	5,937
Minors Support Administration	10,927	10,912	10,612	300
Vocational Rehabilitation Administration	13,455	13,452	13,623	(171)
Social Economic Development Administration	97,710	94,447	75,889	18,558
Office of the Disabled Persons Ombudsman	3,580	3,804	3,645	159
Office for Elderly Affairs	3,740	3,740	3,353	387
Patient Ombusman	4,399	4,357	3,917	440
Right to Employment Administration	15,463	15,974	13,688	2,286
Cantera's Peninsula Integral Development Company	413	413	392	21
Industries for the Blind, Mentally Retarded, and Other Disabled				
Persons of Puerto Rico	150	150	150	—
Administration for the Care and Development of the Childhood	13,142	12,638	11,462	1,176
Total public housing and welfare	478,586	479,342	439,626	39,716
Education				
Department of Education	2,417,401	2,419,637	2,610,937	(191,300)
State Office for Historic Preservation	2,144	2,203	2,205	(2)
General Education Council	2,023	2,013	1,838	175
Athenaeum of Puerto Rico	475	475	475	—
Institute of Puerto Rico Culture	30,242	30,291	28,357	1,934
School of Plastics Arts	3,096	3,247	3,077	170
University of Puerto Rico	790,746	790,746	786,746	4,000
Musical Arts Corporation	6,182	6,182	5,884	298
Fine Arts Center Corporation	5,642	5,642	5,278	364
Puerto Rico Public Broadcasting Corporation	19,379	19,379	18,454	925
Puerto Rico Conservatory of Music Corporation	4,556	4,556	4,243	313
Puerto Rico Council of Higher Education	29,540	29,540	27,091	2,449
Total education	3,311,426	3,313,911	3,494,585	(180,674)
Economic development				
Department of Transportation and Public Works	73,940	74,443	69,677	4,766
Department of Natural and Environmental Resources	1,857	1,926	2,631	(705)
Department of Agriculture	22,790	24,274	23,375	899
Department of Economic Development and Commerce	68	(12)	(12)	—
Cooperative Enterprises Development Administration	3,162	3,113	3,031	82
Puerto Rico Highway and Transportation Authority	6,000	6,000	6,000	—
Cooperative Enterprises Inspector's Office	792	961	882	79
Rural Development Corporation	4,016	4,016	3,914	102
Department of Economic Development and Commerce	3,292	3,292	2,843	449
Energy Affairs Administration	149	156	141	15
Culebra Conservation and Development Authority	654	654	589	65
Puerto Rico Infrastructure Financing Agency	90,000	90,000	87,000	3,000
Puerto Rico Industrial Development Company	15,000	14,999	14,999	—
Government Development Bank for Puerto Rico	1,000	1,000	1,000	—
Puerto Rico Metropolitan Bus Authority	5,500	8,500	6,500	2,000
Puerto Rico Maritime Transportation Authority	12,000	14,500	11,750	2,750
Puerto Rico Tourism Company	4,259	4,259	3,034	1,225
Agricultural Services and Development Administration	95,105	93,530	93,530	—
National Parks Company of Puerto Rico	23,000	23,000	21,500	1,500
Corporation for the Development of the Film Industry in				
Puerto Rico	1,164	1,148	1,032	116
Puerto Rico Land Administration	313	313	313	—
Puerto Rico Trade and Export Corporation	10,184	10,252	9,783	469
Total economic development	374,245	380,324	363,512	16,812

**COMMONWEALTH OF PUERTO RICO**

Supplemental Schedule of Expenditures by Agency – Budget and Actual –  
Statutory Basis – General Fund

Year ended June 30, 2007

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Intergovernmental				
Municipal Service Administration	<u>382,608</u>	<u>382,859</u>	<u>382,054</u>	<u>805</u>
Total intergovernmental	<u>382,608</u>	<u>382,859</u>	<u>382,054</u>	<u>805</u>
Total expenditures	<u>\$ 8,511,315</u>	<u>8,547,187</u>	<u>8,785,506</u>	<u>(238,319)</u>
Operating transfer-out to other funds:				
Office of Management and Budget	<u>\$ 177,900</u>	<u>177,900</u>	<u>177,900</u>	<u>—</u>
Employees' Retirement System of the Government				
of Puerto Rico and its Intumentalities	<u>211,033</u>	<u>211,035</u>	<u>206,220</u>	<u>4,815</u>
Puerto Rico System of Annuities and Pensions for Teachers	<u>60,960</u>	<u>60,960</u>	<u>57,960</u>	<u>3,000</u>
Contributions to Political Parties	<u>603</u>	<u>900</u>	<u>900</u>	<u>—</u>
Transfer of Unused Appropriation Fund (Legislative Branch Only)	<u>13,993</u>	<u>13,993</u>	<u>13,993</u>	<u>—</u>
Transfer of Treasury – Transfer to Debt Service	<u>512,197</u>	<u>476,025</u>	<u>464,400</u>	<u>11,625</u>
	<u>\$ 976,686</u>	<u>940,813</u>	<u>921,373</u>	<u>19,440</u>

## NONMAJOR GOVERNMENTAL FUNDS

### *Special Revenue Funds*

Special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditure for specific purposes.

**Public Buildings Authority Special Revenue Fund:** The operating fund of a blended component unit used to account for the operation, maintenance, equipment replacement, and other extraordinary operation and maintenance costs of the buildings and facilities that, when constructed, are leased to the Commonwealth's primary government agencies.

### *Debt Service Funds*

The debt service funds are used to account for the accumulation of resources predominantly for, and the payment of, general long-term bonds principal, interest, and related costs other than bonds payable from operations of proprietary fund types, pension trust funds, and discretely presented component units. Long-term debt and interest due on July 1 of the following year are accounted for as a fund liability if resources are available as of June 30 for its payment.

**The Children's Trust Debt Service Fund:** The debt service fund of The Children's Trust (a blended component unit) accounts for the accumulation of resources for payment of interest and principal on long-term obligations financed with moneys to be received by the Commonwealth from the global settlement agreement signed by certain tobacco companies.

**Public Buildings Authority Debt Service Fund:** A blended component unit engaged in the construction and/or acquisition of building facilities for lease mainly to the Commonwealth's primary government agencies. Its debt service fund is used to account for the accumulation of resources for the payment of revenue bonds and other liabilities incurred to finance the construction of the buildings and facilities.

**Puerto Rico Maritime Shipping Authority Debt Service Fund:** This is the remainder of a former shipping company owned by the Commonwealth. Its debt service fund is used to account for the accumulation of resources for the payment of the long-term liability that resulted from the sale of its marine operations. This fund is mainly subsidized from appropriations and operating transfers from the general fund.

### *Capital Project Funds*

Capital project funds are used to account for the financial resources used for the acquisition or construction of major capital facilities not being financed by proprietary fund types, pension trust funds, and discretely presented component units.

**Commonwealth Public Improvements Funds and Other Funds:** These funds present the activities of the capital improvements program of the Commonwealth, financed with the proceeds of the general obligation bonds.

**COMMONWEALTH OF PUERTO RICO**

Combining Balance Sheet – Nonmajor Governmental Funds

June 30, 2007

(In thousands)

	Special revenue		Debt service		Total	Commonwealth of Puerto Rico	Total nonmajor governmental funds
	Public Buildings Authority	The Children's Trust	Public Buildings Authority	Puerto Rico Maritime Shipping Authority			
Cash and cash equivalents in commercial banks	\$ 9,051	—	—	1,591	1,591	33,502	44,144
Cash and cash equivalents in component unit banks	9,108	—	—	1,940	1,940	317,056	328,104
Investments	—	114,862	—	—	114,862	—	114,862
Receivables, net:							
Accounts	9,938	—	—	—	—	671	10,609
Loans and advances	—	—	—	—	—	36	36
Accrued interest	—	441	—	8	449	—	449
Due from:							
Other funds	125,450	—	21,347	—	21,347	31,214	178,011
Component units	44,074	—	—	—	—	—	44,074
Other governmental entities	394	—	—	—	—	—	394
Restricted cash and cash equivalents in commercial banks	—	—	150,100	—	150,100	—	150,100
Real estate held for future development	14,386	—	—	—	—	1,852	16,238
Total assets	\$ 212,401	115,303	171,447	3,539	290,289	384,331	887,021
Liabilities and Fund Balances							
Liabilities:							
Accounts payable and accrued liabilities	\$ 46,963	—	—	776	776	28,945	76,684
Due to component units	20,374	—	—	—	—	—	20,374
Interest payable	—	—	80,608	1,433	82,041	—	82,041
Notes payable	129,112	—	—	—	—	—	129,112
Bonds payable	—	—	75,690	—	75,690	—	75,690
Total liabilities	196,449	—	156,298	2,209	158,507	28,945	383,901
Fund balances:							
Reserved for:							
Encumbrances	—	—	—	—	—	97,721	97,721
Unreserved reported in:							
Debt service funds	—	115,303	15,149	1,330	131,782	—	131,782
Special revenue funds	15,952	—	—	—	—	—	15,952
Capital projects funds	—	—	—	—	—	257,665	257,665
Total fund balances	15,952	115,303	15,149	1,330	131,782	355,386	503,120
Total liabilities and fund balances	\$ 212,401	115,303	171,447	3,539	290,289	384,331	887,021

See accompanying independent auditors' report.

# COMMONWEALTH OF PUERTO RICO

Combining Statement of Revenue, Expenditures, and Changes in  
Fund Balances – Nonmajor Governmental Funds

Year ended June 30, 2007

(In thousands)

	Special revenue		Debt service		Capital projects		Total nonmajor governmental funds
	Public Buildings Authority	The Children's Trust	Public Buildings Authority	Puerto Rico Maritime Shipping Authority	Commonwealth of Puerto Rico		
Revenue:							
Revenue from global tobacco settlement agreement	—	68,665	—	—	—	68,665	68,665
Interest and investment earnings	7,438	4,468	—	236	—	4,704	12,142
Revenue from Puerto Rico Sales Tax Financing Corporation	—	—	—	16,956	—	16,956	16,956
Intergovernmental	—	—	—	—	—	—	16,309
Other	5,251	—	—	13	—	13	5,264
Total revenue	12,689	73,133	—	17,205	—	90,338	119,336
Expenditures:							
Current:							
General government	182,623	—	—	—	41,641	—	224,264
Public safety	—	—	—	—	1,108	—	1,108
Health	—	—	—	—	7,059	—	7,059
Public housing and welfare	—	—	—	—	1,773	—	1,773
Education	—	—	—	—	23,503	—	23,503
Economic development	—	—	—	—	18,092	814	18,906
Intergovernmental	—	—	—	814	166,895	—	166,895
Capital outlays	—	—	—	—	56,445	—	56,445
Debt service:							
Principal	—	12,030	75,690	—	—	87,720	87,720
Interest and other	—	60,470	97,564	16,956	—	174,990	174,990
Debt issue costs	—	—	—	—	8,330	—	8,330
Total expenditures	182,623	72,500	173,254	17,770	324,846	263,524	770,993
Excess (deficiency) of revenue over (under) expenditures	(169,934)	633	(173,254)	(565)	(308,537)	(173,186)	(651,657)
Other financing sources (uses):							
Transfers in	—	—	162,153	—	—	162,153	162,153
Transfers out	(6,454)	(243)	—	(674)	(328,418)	(917)	(335,789)
Long-term debt issued	—	—	—	—	716,565	—	716,565
Total other financing sources (uses)	(6,454)	(243)	162,153	(674)	388,147	161,236	542,929
Net change in excess (deficiency) of revenue and other fund balances (deficit)	(176,388)	390	(11,101)	(1,239)	79,610	(11,950)	(108,728)
Fund balances, beginning of year	192,340	114,913	26,250	2,569	275,776	143,732	611,848
Fund balances, end of year	15,952	115,303	15,149	1,330	355,386	131,782	503,120

See accompanying independent auditors' report.

## NONMAJOR PROPRIETARY FUNDS

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the government is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

**Disability Insurance:** It was created by Act 139 on June 26, 1968. It is used to account for disability benefits to remedy temporarily the loss of income as a result of disability caused by sickness or accident unrelated to the employment.

**Drivers' Insurance:** It was created by Act 428 on May 15, 1950. It is used to account for contributions made by the drivers and their employers to provide a social security plan for the benefit of the drivers in Puerto Rico. The plan also includes payment of benefits for health and life insurance.

**Puerto Rico Water Pollution Control Revolving Fund:** It was created by Act No. 44 on June 21, 1988, as amended. It is administered, pursuant to Act No. 9 of June 18, 1970, as amended, by the Puerto Rico Environmental Quality Board (EQB). Pursuant to such Act, EQB is authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (EPA) for lending activities.

**Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund:** It was created by Act No. 32 on July 7, 1997. It is administered, pursuant to Act No. 9 of June 18, 1970, as amended, by the Puerto Rico Department of Health (DOH). Pursuant to such act, DOH, on behalf of the Commonwealth, is authorized to enter into operating and capitalization grant agreements with the EPA for lending activities.

**COMMONWEALTH OF PUERTO RICO**  
Combining Statement of Net Assets – Nonmajor Proprietary Funds  
June 30, 2007  
(In thousands)

Assets	Business type activities – nonmajor enterprise funds				
	Disability insurance	Drivers' insurance	Puerto Rico Water Pollution Control Revolving Fund	Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	Total
Current assets:					
Cash and cash equivalents in commercial banks	\$ —	37,585	59,013	6,609	103,207
Cash and cash equivalents in governmental banks	80,059	—	—	—	80,059
Receivables, net:					
Insurance premiums, net	3,545	1,055	—	—	4,600
Component units	—	—	7,519	1,328	8,847
Accrued interest	217	80	1,501	692	2,490
Other	203	36	109	76	424
Total current assets	84,024	38,756	68,142	8,705	199,627
Noncurrent assets:					
Loans receivable from component units, excluding current portion, net	—	—	148,406	71,920	220,326
Restricted investments	35,606	—	—	—	35,606
Other	—	—	1,710	—	1,710
Total assets	119,630	38,756	218,258	80,625	457,269
<b>Liabilities and Net Assets</b>					
Current liabilities:					
Accounts payable and accrued liabilities	1,730	183	417	157	2,487
Deferred revenue	—	28	—	—	28
Compensated absences	887	712	—	—	1,599
Insurance benefits payable	851	283	—	—	1,134
Total current liabilities	3,468	1,206	417	157	5,248
Noncurrent liabilities – compensated absences	332	—	—	—	332
Total liabilities	3,800	1,206	417	157	5,580
Net assets:					
Restricted for:					
Payment of insurance benefits	115,830	37,550	—	—	153,380
Capital projects	—	—	217,841	80,468	298,309
Total net assets (deficit)	\$ 115,830	37,550	217,841	80,468	451,689

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Revenue, Expenses and Changes in Net Assets –  
Nonmajor Proprietary Funds

Year ended June 30, 2007

(In thousands)

	<b>Business type activities – nonmajor enterprise funds</b>				
	<b>Disability Insurance</b>	<b>Drivers' Insurance</b>	<b>Puerto Rico Water Pollution Control Revolving Fund</b>	<b>Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund</b>	<b>Total</b>
Operating revenues:					
Insurance premiums	\$ 15,711	4,602	—	—	20,313
Interest	—	—	5,860	1,574	7,434
Total operating revenues	15,711	4,602	5,860	1,574	27,747
Operating expenses:					
Disability and drivers' insurance benefits	3,352	1,158	—	—	4,510
General, administrative, and other operating expenses	17,232	3,981	587	550	22,350
Total operating expenses	20,584	5,139	587	550	26,860
Operating income (loss)	(4,873)	(537)	5,273	1,024	887
Nonoperating revenue:					
Contributions from federal government	—	—	16,821	20,079	36,900
Interest and investment earnings	1,241	967	—	—	2,208
Total nonoperating revenue	1,241	967	16,821	20,079	39,108
Income (loss) before transfers	(3,632)	430	22,094	21,103	39,995
Transfers from general fund	—	—	3,364	4,094	7,458
Transfers to general fund	—	—	—	(87)	(87)
Net change in net assets	(3,632)	430	25,458	25,110	47,366
Net assets, at beginning of year	119,462	37,120	192,383	55,358	404,323
Net assets, at end of year	\$ 115,830	37,550	217,841	80,468	451,689

See accompanying independent auditors' report.



**COMMONWEALTH OF PUERTO RICO**  
Combining Statement of Cash Flows – Nonmajor Proprietary Funds  
Year ended June 30, 2007  
(In thousands)

	Business type activities – nonmajor enterprise funds				Total
	Disability Insurance	Drivers' Insurance	Puerto Rico Water Pollution Control Revolving Fund	Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	
Cash flows from operating activities:					
Receipts from customers and users	\$ 19,316	4,539	—	—	23,855
Other receipts	—	—	13,209	2,220	15,429
Payments to suppliers and employees	(17,774)	(4,443)	—	—	(22,217)
Payments of insurance benefits	(3,391)	(1,232)	—	—	(4,623)
Other payments	—	—	(24,835)	(26,039)	(50,874)
Net cash used in operating activities	(1,849)	(1,136)	(11,626)	(23,819)	(38,430)
Cash flows from noncapital financing activities:					
Intergovernmental grants and contributions	—	—	16,821	20,079	36,900
Transfers from general fund	—	—	3,364	4,094	7,458
Transfers to other funds	—	—	—	(87)	(87)
Net cash provided by noncapital financing activities	—	—	20,185	24,086	44,271
Cash flows from investing activities:					
Interest received on deposits and investments	1,214	964	—	—	2,178
Purchases of investments	(2,133)	—	—	—	(2,133)
Net cash provided by (used in) investing activities	(919)	964	—	—	45
Net increase (decrease) in cash and cash equivalents	(2,768)	(172)	8,559	267	5,886
Cash and equivalents at beginning of year	82,827	37,757	50,454	6,342	177,380
Cash and cash equivalents at end of year	\$ 80,059	37,585	59,013	6,609	183,266
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:					
Operating income (loss)	\$ (4,873)	(537)	5,273	1,024	887
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:					
Interests earned on deposits loans and investments	—	—	62	(235)	(173)
Changes in operating assets and liabilities:					
Decrease (increase) in accounts and loan receivable	3,605	(63)	(16,546)	(24,464)	(37,468)
Increase (decrease) in deferred revenues	—	2	—	—	2
Increase (decrease) in compensated absences	(632)	(554)	—	—	(1,186)
Increase (decrease) in liability for insurance benefits payable	(39)	(74)	—	—	(113)
Increase (decrease) in accounts payable and accrued liabilities	90	90	(415)	(155)	(390)
Decrease in other assets	—	—	—	11	11
Total adjustments	3,024	(599)	(16,899)	(24,843)	(39,317)
Net cash used in operating activities	\$ (1,849)	(1,136)	(11,626)	(23,819)	(38,430)

See accompanying independent auditors' report.

## FIDUCIARY FUNDS

Fiduciary funds are used to account for held by the Commonwealth in a trustee capacity, or as an agent for individuals, organizations, and other governmental units. Following are the Commonwealth's fiduciary funds:

### ***Pension Trust Funds***

The pension trust funds are used to account for the assets, liabilities, and net assets available for pension benefits held in trust for the public employees of the Commonwealth.

**Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS):** ERS is the administrator of a defined-benefit pension plan, which covers all regular employees of the Commonwealth and its instrumentalities and of certain municipalities and component units not covered by their retirement systems. On September 24, 1999, an amendment to the law that created ERS was enacted with the purpose of establishing a new defined-contribution pension plan (System 2000) for persons joining the government on or after January 1, 2000.

**Puerto Rico System of Annuities and Pensions for Teachers (TRS):** TRS provides retirement benefits to all teachers of the Department of Education of the Commonwealth, all pensioned teachers who work in the Teachers' Association of Puerto Rico, and those who practice in private institutions accredited by the Department of Education of Commonwealth. TRS provides retirement, death, and disability benefits.

**Puerto Rico Judiciary Retirement System (JRS):** JRS is administered by the ERS and covers all individuals holding a position as Justice of the Supreme Court, Judge of the former Superior Court, Judge of District Court, or the Municipal Judges of the Commonwealth. The system provides retirement as well as death and disability benefits.

### ***Agency Fund***

Agency fund is used to account for assets held by the Commonwealth as an agent for individuals, private organizations, and other governments. This fund is custodial in nature (assets equal liabilities) and does not involve measurement of the results of operations.

**Special Deposits:** This fund acts in a fiduciary capacity in order to account for moneys received with specified purposes for which the law does not specify its recording in any other fund. It mainly includes deposits under the custody of the courts of justice for alimony payments.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Fiduciary Net Assets – Pension Trust Funds

June 30, 2007

(In thousands)

Assets	Pension Trust Funds			Total
	Employees' Retirement System (ERS)	Teachers' Retirement System (TRS)	Judiciary Retirement System (JRS)	
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ 41,365	33,542	2,735	77,642
Cash and cash equivalents in governmental banks:				
Unrestricted	266,633	3,123	197	269,953
Restricted	2,310	—	—	2,310
Investments:				
Debt equity securities, at fair value	1,842,783	2,686,485	89,382	4,618,650
Other	47,784	46,686	—	94,470
Receivables, net:				
Accounts	119,890	—	—	119,890
Loans and advances	577,314	364,121	256	941,691
Accrued interest and dividends	3,119	6,312	237	9,668
Due from (to) other pension trust funds	5,113	—	(5,113)	—
Due from general fund	4,615	—	—	4,615
Other	4,527	26,882	230	31,639
Capital assets, net	8,476	25,890	—	34,366
Other assets	7,371	700	—	8,071
Total assets	2,931,300	3,193,741	87,924	6,212,965
<b>Liabilities</b>				
Accounts payable and accrued liabilities	38,233	31,017	6,451	75,701
Other liabilities	1,566	4	—	1,570
Total liabilities	39,799	31,021	6,451	77,271
<b>Net Assets</b>				
Net assets held in trust for pension and other benefits	\$ 2,891,501	3,162,720	81,473	6,135,694

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Changes in Fiduciary Net Assets – Pension Trust Funds

Year ended June 30, 2007

(In thousands)

	Pension Trust Funds			Total
	Employees' Retirement System (ERS)	Teachers' Retirement System (TRS)	Judiciary Retirement System (JRS)	
Additions:				
Contributions:				
Sponsor	\$ 374,394	116,320	6,632	497,346
Participants	338,791	127,809	2,828	469,428
Special	86,097	70,356	—	156,453
Total contributions	<u>799,282</u>	<u>314,485</u>	<u>9,460</u>	<u>1,123,227</u>
Interest and investment income:				
Interest	68,231	65,367	1,447	135,045
Dividends	14,494	13,654	224	28,372
Net change in fair value of investments	364,185	406,131	12,438	782,754
Investment expenses	(12,940)	(6,217)	(192)	(19,349)
Net interest and investment income	<u>433,970</u>	<u>478,935</u>	<u>13,917</u>	<u>926,822</u>
Other income	<u>19,872</u>	<u>1,299</u>	<u>—</u>	<u>21,171</u>
Total additions	<u>1,253,124</u>	<u>794,719</u>	<u>23,377</u>	<u>2,071,220</u>
Deductions:				
Pension and other benefits	831,658	410,562	13,461	1,255,681
Refunds of contributions	33,305	5,447	38	38,790
General and administrative	37,991	22,877	1,255	62,123
Total deductions	<u>902,954</u>	<u>438,886</u>	<u>14,754</u>	<u>1,356,594</u>
Net change in net assets held in trust for pension and other benefits	<u>350,170</u>	<u>355,833</u>	<u>8,623</u>	<u>714,626</u>
Net assets held in trust for pension and other benefits:				
Beginning of year	<u>2,541,331</u>	<u>2,806,887</u>	<u>72,850</u>	<u>5,421,068</u>
End of year	<u>\$ 2,891,501</u>	<u>3,162,720</u>	<u>81,473</u>	<u>6,135,694</u>

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**  
Statement of Changes in Assets and Liabilities – Agency Fund  
Year ended June 30, 2007  
(In thousands)

<b>Assets</b>	<b>Balance June 30, 2006</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance June 30, 2007</b>
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ 583,196	70,114	—	653,310
Cash and cash equivalents in governmental banks	46,984	3,501,221	3,358,751	189,454
Investments	27,013	—	11,407	15,606
Total assets	<u>\$ 657,193</u>	<u>3,571,335</u>	<u>3,370,158</u>	<u>858,370</u>
<b>Liabilities</b>				
Accounts payables and accrued liabilities	\$ 657,193	4,277,726	4,076,549	858,370
Total liabilities	<u>\$ 657,193</u>	<u>4,277,726</u>	<u>4,076,549</u>	<u>858,370</u>

See accompanying independent auditors' report.

## **NONMAJOR COMPONENT UNITS**

These entities are presented because the nature and significance of their relationship with the primary government are such that their exclusion would cause the basic financial statements to be misleading. These are discretely presented in a separate column in the basic financial statements due to nature of the services they provide. The accounting principles followed by each of the component units included herein may vary depending on the type of industries they are involved in (that is, banking, construction, public utilities, and so forth). The detailed information for each of these entities may be obtained directly from the administrative offices of the corresponding entities, as described in note 1 to the basic financial statements included in the financial section of this report.

**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units –  
Statement of Net Assets  
June 30, 2007

Assets	Agricultural Services and Development Corporation	Automobile Accidents Compensation Administration	Cardiovascular Center Corporation of Puerto Rico and the Caribbean	Caribbean Basin Projects Financing Authority	Culebra Conservation and Development Authority	Economic Development Bank for Puerto Rico	Employment and Training Enterprises Corporation	Farm Insurance Corporation of Puerto Rico	Fine Arts Center Corporation	Governing Board of the 9-1-1 Service	Institute of Puerto Rican Culture	Institutional Trust of the National Guard of Puerto Rico
<b>Assets</b>												
<b>Current assets:</b>												
Cash and cash equivalents in commercial banks	\$ 12	2,210	2,910	—	308	1,984	—	1,692	2,804	—	4,189	—
Cash and cash equivalents in governmental banks	—	5,142	—	4	—	28	9	—	301	21,457	—	66,743
Investments, including collateral from securities lending transactions	—	233,167	—	—	—	177,989	—	—	—	—	—	694
Receivables, net:												
Insurance premium	—	—	—	—	—	—	—	—	—	—	—	—
Intergovernmental	—	—	—	—	—	—	—	—	—	—	—	—
Accounts	6,365	3,059	20,862	—	—	—	485	2,820	191	4,105	338	—
Loans and advances	—	—	—	—	—	57,334	—	—	—	—	—	—
Accrued interest	—	1,153	—	—	—	10,954	—	—	—	67	—	—
Other governmental entities	18,732	—	—	—	—	—	—	—	1	128	458	—
Other	236,626	3,457	1,243	—	—	—	—	—	—	—	—	5,476
Due from:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	—
Component units	—	—	—	—	—	—	341	13,257	—	—	1,502	—
Inventories	14,735	—	2,638	—	—	—	—	—	—	31	—	—
Prepays	629	—	419	—	—	—	—	324	161	—	—	—
<b>Total current assets</b>	<b>277,099</b>	<b>248,188</b>	<b>28,072</b>	<b>4</b>	<b>308</b>	<b>248,289</b>	<b>835</b>	<b>18,093</b>	<b>3,458</b>	<b>25,788</b>	<b>6,487</b>	<b>72,913</b>
<b>Noncurrent assets:</b>												
<b>Restricted assets:</b>												
Cash and cash equivalents in commercial banks	2	245	500	—	—	—	1,025	4,036	410	—	14,061	—
Cash and cash equivalents in governmental banks	—	—	—	—	—	—	703	—	—	20,247	4,739	3,000
Investments and other restricted assets	—	—	—	—	—	712,610	—	—	1,138	—	—	—
Investments	—	—	—	—	—	—	—	—	2,592	—	—	—
Receivables:												
Loans, interest and other	—	—	—	—	—	112,796	—	—	—	—	—	—
Interest-bearing deposits with other banks	—	—	—	—	—	—	—	—	—	—	—	—
Other governmental entities	—	—	—	—	—	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—	—	—	—	—	—
Due from:												
Component units	—	—	—	—	—	—	—	—	—	—	—	—
Property held for sale and future development	—	—	—	—	—	—	—	—	—	—	—	—
Capital assets, not being depreciated	6,817	901	5,024	—	640	—	—	—	—	—	14,121	5,483
Capital assets, depreciable, net	28,650	8,882	6,650	—	434	10,200	325	219	14,759	4,422	73,267	4,461
Deferred expenses and other assets	343	37	—	—	—	4,592	—	—	—	—	—	2,059
<b>Total noncurrent assets</b>	<b>36,012</b>	<b>10,065</b>	<b>12,174</b>	<b>—</b>	<b>1,074</b>	<b>840,198</b>	<b>2,053</b>	<b>4,255</b>	<b>21,999</b>	<b>24,669</b>	<b>106,188</b>	<b>15,003</b>
<b>Total assets</b>	<b>\$ 313,111</b>	<b>\$ 258,253</b>	<b>\$ 40,246</b>	<b>\$ 4</b>	<b>\$ 1,382</b>	<b>\$ 1,088,487</b>	<b>\$ 2,888</b>	<b>\$ 22,348</b>	<b>\$ 25,457</b>	<b>\$ 50,457</b>	<b>\$ 112,675</b>	<b>\$ 87,916</b>

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units –  
Statement of Net Assets  
June 30, 2007

Assets	Land Authority of Puerto Rico	Musical Arts Corporation	National Parks Company of Puerto Rico	Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	Puerto Rico Conservatory of Music Corporation	Puerto Rico Convention Center District Authority	Puerto Rico Council on Higher Education	Puerto Rico Development Company	Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	Puerto Rico Land Administration	Puerto Rico Medical Services Administration	Puerto Rico Metropolitan Bus Authority
<b>Assets:</b>												
<b>Current assets:</b>												
Cash and cash equivalents in commercial banks	2,700	2,009	—	—	257	20,818	—	39,295	—	612	—	800
Cash and cash equivalents in governmental banks	47,039	—	3,253	549	—	1,078	1,670	37,337	8,547	79,837	—	6
Investments, including collateral from securities lending transactions	—	—	—	139,930	—	—	—	—	—	29,677	—	—
Receivables, net:												
Insurance premium	—	—	—	—	—	—	—	—	—	—	—	—
Intergovernmental	—	—	—	—	—	—	—	—	—	—	—	—
Accounts	12,428	89	1,159	—	—	13,876	102	23,612	—	5,392	9,174	2,422
Loans and advances	546	—	—	—	—	—	—	473	—	—	947	—
Accrued interest	736	—	—	2,203	—	—	—	330	33	969	—	—
Other governmental entities	—	361	443	—	71	—	1,000	—	—	—	34,785	—
Other	498	9	—	151	9	78	—	23,293	—	6	—	6,746
Due from:												
Primary government	3,637	—	—	—	14,189	—	—	23,403	—	—	33,983	—
Component units	2,923	—	—	—	—	—	—	—	—	1,305	4,331	—
Inventories	—	—	—	—	—	—	—	—	—	—	—	6,398
Prepays	—	—	626	—	30	987	—	2,098	—	121	621	—
<b>Total current assets</b>	<b>70,507</b>	<b>2,468</b>	<b>5,481</b>	<b>142,833</b>	<b>14,556</b>	<b>36,837</b>	<b>2,772</b>	<b>149,841</b>	<b>8,580</b>	<b>117,919</b>	<b>83,841</b>	<b>16,372</b>
<b>Noncurrent assets:</b>												
<b>Restricted assets:</b>												
Cash and cash equivalents in commercial banks	647	396	—	—	1,452	—	—	56,854	—	—	2,751	—
Cash and cash equivalents in governmental banks	809	—	22,828	—	—	82,442	4,577	—	—	400	—	267
Investments and other restricted assets	—	—	—	—	—	—	—	—	—	—	—	—
Investments	5,909	—	—	8,964	—	—	—	4,372	—	—	—	—
Receivables:												
Loans, interest and other	994	—	—	—	—	—	—	1,739	—	—	236	—
Interest-bearing deposits with other banks	—	—	—	—	—	5,174	—	—	—	—	—	—
Other governmental entities	—	—	—	—	—	—	—	—	—	771	—	—
Other	—	—	—	—	—	—	—	—	—	—	—	—
Due from:												
Component units	6,431	—	—	—	—	—	—	—	—	2,611	—	—
Property held for sale and future development	—	—	—	—	—	5,650	—	—	—	—	—	—
Capital assets, not being depreciated	80,501	153	26,781	—	31,385	238,358	—	36,481	—	140,345	8,131	2,569
Capital assets, depreciable, net	10,890	401	212,389	220	1,761	442,032	374	268,246	—	23,341	43,008	56,307
Deferred expenses and other assets	2	—	—	—	—	16,525	—	454,616	—	5,329	—	—
<b>Total noncurrent assets</b>	<b>106,183</b>	<b>950</b>	<b>261,998</b>	<b>9,184</b>	<b>34,598</b>	<b>790,181</b>	<b>4,951</b>	<b>825,963</b>	<b>—</b>	<b>172,797</b>	<b>54,126</b>	<b>59,143</b>
<b>Total assets</b>	<b>176,690</b>	<b>3,418</b>	<b>267,479</b>	<b>152,017</b>	<b>49,154</b>	<b>827,018</b>	<b>7,723</b>	<b>975,804</b>	<b>8,580</b>	<b>290,716</b>	<b>137,967</b>	<b>75,515</b>

See accompanying independent auditors' report.



**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units --  
Statement of Net Assets  
June 30, 2007

Assets	Puerto Rico Municipal Finance Agency	Puerto Rico Ports Authority	Puerto Rico Public Broadcasting Corporation	Puerto Rico School of Plastic Arts	Puerto Rico Solid Waste Authority	Puerto Rico Telephone Authority	Puerto Rico Tourism Company	Puerto Rico Trade and Export Company	Right to Employment Administration	Special Communities Perpetual Trust	State Insurance Fund Corporation	Total
<b>Assets:</b>												
Current assets:												
Cash and cash equivalents in commercial banks	—	1,621	4,024	—	—	—	36,613	3,248	—	—	3,281	131,387
Cash and cash equivalents in governmental banks	3,464	103	—	204	348	579	—	3,613	2,905	—	230,982	515,198
Investments, including collateral from securities lending transactions	244,319	—	—	—	2,843	—	57,072	—	—	—	793,596	1,679,287
Receivables, net:												
Insurance premium	—	—	—	—	—	—	—	—	—	—	108,709	108,709
Intergovernmental	—	—	—	—	—	—	—	—	—	—	—	2,422
Accounts	—	81,005	441	765	2,510	—	6,213	364	—	—	—	195,355
Loans and advances	—	—	—	—	—	—	—	—	—	—	—	59,300
Accrued interest	—	—	—	—	—	—	—	—	—	—	9,511	33,487
Other governmental entities	—	—	276	—	—	—	—	3,795	4,035	3,736	—	60,377
Other	—	—	559	—	—	—	807	87	27	146	15,899	295,030
Due from:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	75,212
Component units	—	—	—	—	—	—	—	—	—	—	—	3,500
Inventories	—	320	—	—	—	—	—	—	—	—	7,759	20,985
Prepaids	—	6,030	84	—	158	—	4	—	—	—	—	38,055
	247,783	89,079	5,384	969	5,859	579	100,709	13,628	6,967	3,882	1,173,237	3,229,617
<b>Total current assets</b>												
Noncurrent assets:												
Restricted assets:												
Cash and cash equivalents in commercial banks	4,439	29,316	2,626	139	—	—	—	12,370	—	—	—	131,269
Cash and cash equivalents in governmental banks	—	46,227	—	216	5,561	15,275	—	12,177	380	455,315	—	592,721
Investments and other restricted assets	1,596,263	—	—	865	12,452	1,850	—	250,000	3,076	—	—	1,932,634
Investments	—	1,000	—	—	—	—	34,733	—	—	—	781,816	1,564,448
Receivables:												
Loans, interest and other	—	—	—	—	—	131	—	218	—	3,742	—	119,856
Interest-bearing deposits with other banks	—	—	—	—	—	—	—	—	—	—	—	5,174
Other governmental entities	—	30,846	—	—	—	—	—	—	—	—	—	31,617
Other	—	—	—	—	—	—	—	—	—	—	—	481
Due from:												
Component units	—	—	—	—	—	—	—	—	—	—	—	9,042
Property held for sale and future development	—	—	—	—	—	—	—	—	—	—	—	182,476
Capital assets, not being depreciated	—	422,981	708	—	41,952	—	14,235	69,708	—	—	13,010	1,278,145
Capital assets, depreciable, net	—	418,653	21,521	8,595	140,864	—	25,628	45,294	399	—	93,937	2,134,487
Deferred expenses and other assets	45	9,663	215	—	—	—	21,866	4	—	—	—	58,725
Total noncurrent assets	1,600,747	958,686	25,070	9,815	200,829	17,256	96,462	389,771	3,855	459,057	888,763	8,044,075
<b>Total assets</b>	1,848,530	1,047,765	30,454	10,784	206,688	17,835	197,171	403,399	10,822	462,939	2,062,000	11,273,692

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units –  
Statement of Net Assets  
June 30, 2007

Liabilities and Net Assets	Cardiovascular Center Corporation of Puerto Rico and the Caribbean										Culebra Conservation and Development Authority		Economic Development Bank for Puerto Rico		Employment and Training Enterprises Corporation		Farm Insurance Corporation of Puerto Rico		Fine Arts Center Corporation		Governing Board of the 9-1-1 Service		Institute of Puerto Rican Culture		Institutional Trust of the National Guard of Puerto Rico	
	Agricultural Services and Development Corporation	Automobile Accidents Compensation Administration	Caribbean Basin Projects Financing Authority	Caribbean Basin Projects Financing Authority	Culebra Conservation and Development Authority	Economic Development Bank for Puerto Rico	Employment and Training Enterprises Corporation	Farm Insurance Corporation of Puerto Rico	Fine Arts Center Corporation	Governing Board of the 9-1-1 Service	Institute of Puerto Rican Culture	Institutional Trust of the National Guard of Puerto Rico														
Liabilities:																										
Current liabilities:																										
Accounts payable and accrued liabilities	\$ 247,996	7,609	22,755	4	27	—	1,792	783	284	2,022	7,755	1,379														
Deposits and escrow liabilities	—	—	—	—	—	287,867	—	—	125	—	—	—														
Due to:																										
Primary government	—	—	44,074	—	—	—	—	—	—	5,515	—	—														
Component units	16,180	—	7,192	—	—	352	—	—	—	—	—	—														
Other governmental entities	7,677	—	—	—	—	—	—	—	—	—	—	—														
Securities lending transactions and reverse repurchase agreements	—	58,981	—	—	—	149,878	—	—	—	—	—	—														
Interest payable	—	—	—	—	—	8,421	—	5,232	808	—	—	—														
Deferred revenue	—	36,376	—	—	26	—	—	—	—	—	—	—														
Notes payable, current portion	9,833	—	—	—	—	—	—	—	—	—	—	—														
Commonwealth appropriation bonds, current portion	—	—	—	—	—	—	—	—	—	—	—	—														
Bonds payable, current portion	—	—	—	—	—	—	—	—	—	—	—	—														
Accrued compensated absences	10,205	4,206	2,474	—	79	—	266	414	49	755	338	105														
Workers compensation claims	—	—	—	—	—	—	—	—	—	—	—	—														
Liability for automobile accident benefit payments	—	118,273	—	—	—	—	—	—	—	—	—	—														
Current portion of other long-term liabilities	236	—	273	—	—	3,410	—	—	—	—	—	—														
Total current liabilities	292,127	225,445	76,768	4	132	449,928	2,058	6,429	1,266	8,292	8,093	1,484														
Noncurrent liabilities:																										
Due to:																										
Primary government	—	—	—	—	—	—	7,108	—	—	—	22,756	—														
Component units	127,578	—	—	—	—	11,524	788	6,431	—	—	—	—														
Deferred revenue	—	—	—	—	—	500,000	—	—	—	—	—	—														
Notes payable	—	—	—	—	—	—	—	—	—	—	—	—														
Commonwealth appropriation bonds	—	—	—	—	—	—	—	—	—	—	—	—														
Bonds payable	—	—	—	—	—	2,310	—	—	—	—	—	—														
Compensated absences	—	—	—	—	72	788	—	—	575	—	3,311	—														
Other long-term liabilities	287	—	1,374	—	—	—	—	—	—	—	—	—														
Total noncurrent liabilities	127,865	—	1,374	—	72	514,622	7,896	6,431	575	—	26,067	—														
Total liabilities	419,992	225,445	78,142	4	204	964,550	9,954	12,860	1,841	8,292	34,160	1,484														
Net assets:																										
Invested in capital assets, net of related debt	—	9,783	11,674	—	1,074	(1,675)	325	219	17,353	4,352	62,792	9,943														
Restricted for:																										
Capital projects	—	—	500	—	—	—	—	—	1,548	—	5,747	—														
Debt service	—	—	—	—	—	—	—	—	—	—	—	—														
Affordable housing and related loan insurance programs	—	—	—	—	—	—	—	—	—	—	—	—														
Student loans and other educational purposes	—	—	—	—	—	9,665	—	—	—	20,247	8,065	500														
Other specified purposes	—	245	—	—	—	115,947	(7,391)	4,036	—	17,566	1,911	2,500														
Unrestricted (deficit)	(106,881)	22,780	(50,070)	—	104	—	—	5,233	4,715	—	—	73,489														
Total net assets (deficit)	(106,881)	32,808	(37,896)	—	1,178	123,937	(7,066)	9,488	23,616	42,165	78,515	86,432														
Total liabilities and net assets (deficit)	\$ 313,111	\$ 258,253	\$ 40,246	4	\$ 1,382	\$ 1,088,487	\$ 2,888	\$ 22,348	\$ 25,457	\$ 50,457	\$ 112,675	\$ 87,916														

**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units –  
Statement of Net Assets  
June 30, 2007

Liabilities and Net Assets	Land Authority of Puerto Rico	Musical Arts Corporation	National Parks Company of Puerto Rico	Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	Puerto Rico Conservatory of Music Corporation	Puerto Rico Convention Center District Authority	Puerto Rico Council on Higher Education	Puerto Rico Industrial Development Company	Puerto Rico Industrial, Medical, Educational, and Environmental Control Facilities Financing Authority	Puerto Rico Land Administration	Puerto Rico Medical Services Administration	Puerto Rico Metropolitan Bus Authority
<b>Liabilities:</b>												
Current liabilities:												
Accounts payable and accrued liabilities	61,587	1,505	7,308	12,886	2,711	8,200	303	54,689	100	3,077	81,319	12,459
Deposits and escrow liabilities	10,647	—	—	—	—	3,083	—	4,034	—	1,405	—	—
Due to:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	—
Component units	36,741	—	3,830	—	—	155,221	—	82,380	—	—	43,070	—
Other governmental entities	260	—	2,265	—	—	—	—	—	—	—	44,054	—
Securities lending transactions and reverse repurchase agreements	—	—	—	—	—	—	—	—	—	—	12,212	—
Interest payable	3,576	—	592	—	316	—	—	—	—	—	—	—
Deferred revenue	1,097	—	—	—	—	33,393	—	8,586	—	—	—	252
Notes payable, current portion	2,121	—	—	—	—	5,395	—	4,555	—	—	—	191
Commonwealth appropriation bonds, current portion	613	—	—	—	—	—	—	4,382	—	—	—	4,720
Bonds payable, current portion	—	—	—	—	—	—	—	—	—	—	—	—
Accrued compensated absences	1,359	137	222	1,110	165	3,000	—	6,992	—	—	—	—
Workers compensation claims	—	—	—	—	—	294	—	5,672	—	—	8,719	3,598
Liability for automobile accident benefit payments	—	—	—	—	—	—	—	—	—	—	—	—
Current portion of other long-term liabilities	3,063	—	6,420	—	—	—	—	74	—	—	496	—
Total current liabilities	119,967	2,739	20,637	13,996	3,192	208,586	303	171,364	100	4,482	189,870	21,220
<b>Noncurrent liabilities:</b>												
Due to:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	—
Component units	—	—	—	—	—	5,318	—	2,611	—	—	—	—
Deferred revenue	—	—	—	—	—	—	—	11,284	—	—	—	—
Notes payable	4,241	—	—	—	—	—	—	92,099	—	—	—	40,850
Commonwealth appropriation bonds	162,003	—	—	—	—	—	—	—	—	—	—	—
Bonds payable	—	—	—	—	—	478,722	—	274,143	—	—	—	—
Compensated absences	—	25	5,856	—	753	—	315	—	—	799	—	—
Other long-term liabilities	—	2,442	976	—	1,065	—	—	85	—	38,342	7,068	5,640
Total noncurrent liabilities	166,244	2,467	6,832	—	1,818	484,040	315	380,222	—	39,141	7,068	46,490
Total liabilities	286,211	5,206	27,469	13,996	5,010	692,626	618	551,586	100	43,623	196,938	67,710
<b>Net assets:</b>												
Invested in capital assets, net of related debt	91,341	554	234,749	220	33,146	44,956	374	341,171	—	28,670	47,543	58,877
Restricted for:												
Capital projects	809	—	—	—	10,095	35,851	—	—	—	—	—	267
Debt service	—	—	—	—	—	32,482	—	45,404	—	—	—	—
Affordable housing and related loan insurance program:	—	—	—	—	—	—	—	—	—	—	—	—
Student loans and other educational purposes	—	—	—	—	903	—	5,461	—	—	—	—	—
Other specified purposes	—	396	—	61,700	—	—	1,171	—	—	—	—	—
Unrestricted (deficit)	(201,671)	(2,738)	5,261	76,101	—	21,103	99	37,643	8,480	218,023	(106,517)	(51,339)
Total net assets (deficit)	(109,521)	(1,788)	240,010	138,021	44,144	134,392	7,105	424,218	8,480	247,093	(58,971)	7,805
Total liabilities and net assets (deficit)	176,690	3,418	267,479	152,017	49,154	827,018	7,723	975,804	8,580	290,716	137,967	75,515

**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units –  
Statement of Net Assets

June 30, 2007

Liabilities and Net Assets	Puerto Rico Municipal Finance Agency	Puerto Rico Ports Authority	Puerto Rico Public Broadcasting Corporation	Puerto Rico School of Plastic Arts	Puerto Rico Solid Waste Authority	Puerto Rico Telephone Authority	Puerto Rico Tourism Company	Puerto Rico Trade and Export Company	Right to Employment Administration	Special Communities Perpetual Trust	State Insurance Fund Corporation	Total
Liabilities:												
Current liabilities:												
Accounts payable and accrued liabilities	1,585	116,876	2,626	761	13,910	17	47,235	6,339	9,111	41,156	164,871	943,037
Deposits and escrow liabilities	231,428	1,294	—	—	—	—	—	—	—	—	—	539,883
Due to:												
Primary government	—	—	—	—	—	—	22,178	—	—	—	—	114,837
Component units	—	—	—	—	18,500	—	—	—	—	—	—	364,450
Other governmental entities	—	—	—	—	—	—	—	—	839	—	—	23,253
Securities lending transactions and reverse repurchase agreements	—	—	—	—	—	—	—	—	—	—	149,018	357,877
Interest payable	31,357	2,133	—	—	—	—	—	3,170	—	35,317	—	127,113
Deferred revenue	—	367	276	—	—	—	—	—	53	—	48,064	102,440
Notes payable, current portion	—	127,091	—	—	—	—	—	—	—	—	2,278	150,425
Commonwealth appropriation bonds, current portion	—	—	—	—	—	—	1,916	—	—	—	—	2,529
Bonds payable, current portion	99,035	4,855	—	—	—	—	—	—	—	—	—	113,882
Accrued compensated absences	—	5,582	961	37	456	—	2,025	1,861	1,572	—	45,760	98,421
Workers compensation claims	—	—	—	—	—	—	—	—	—	—	687,829	687,829
Liability for automobile accident benefit payments	—	—	—	—	—	—	—	—	—	—	118,273	118,273
Current portion of other long-term liabilities	—	12,012	—	—	—	10,801	129	—	—	—	375	37,289
Total current liabilities	363,405	270,210	3,863	798	32,866	10,818	73,483	11,370	11,575	76,473	1,098,195	3,781,538
Noncurrent liabilities:												
Due to:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	7,108
Component units	—	2,750	—	—	44,497	—	—	—	—	385,152	—	603,299
Deferred revenue	—	4,147	—	—	—	—	—	—	—	—	—	21,537
Notes payable	—	423,810	—	—	—	—	—	250,000	—	—	49,358	1,360,358
Commonwealth appropriation bonds	—	—	—	—	7,701	—	124,202	—	—	—	—	293,906
Bonds payable	1,398,908	57,009	—	—	—	—	—	—	—	—	—	2,208,782
Compensated absences	—	—	1,503	290	557	—	2,462	—	1,368	—	—	20,196
Other long-term liabilities	16,345	318	—	—	—	—	535	3,795	—	—	84,224	163,284
Total noncurrent liabilities	1,415,253	488,034	1,503	290	52,755	—	127,199	253,795	1,368	385,152	133,582	4,078,470
Total liabilities	1,778,658	758,244	5,366	1,088	85,621	10,818	200,682	265,165	12,943	461,625	1,231,777	8,460,008
Net assets:												
Invested in capital assets, net of related debt	—	318,340	22,229	8,595	110,148	—	39,604	115,002	399	—	22,391	1,634,149
Restricted for:												
Capital projects	—	41,816	1,131	—	2,166	—	—	—	—	—	—	99,930
Debt service	55,057	18,264	—	—	—	—	—	—	—	—	—	151,207
Affordable housing and related loan insurance program	—	—	—	—	—	—	—	—	—	417,927	—	417,927
Student loans and other educational purposes	—	—	—	865	—	—	—	—	—	—	—	7,729
Other specified purposes	—	3,409	1,220	—	—	6,455	—	500	—	—	—	120,012
Unrestricted (deficit)	14,815	(92,308)	508	236	8,753	562	(43,115)	22,732	(2,520)	(416,613)	807,832	382,730
Total net assets (deficit)	69,872	289,521	25,088	9,696	121,067	7,017	(3,511)	138,234	(2,121)	1,314	830,223	2,813,684
Total liabilities and net assets (deficit)	1,848,530	1,047,765	30,454	10,784	206,688	17,835	197,171	403,399	10,822	462,939	2,062,000	11,273,692

**COMMONWEALTH OF PUERTO RICO**  
**Nonmajor Discreetly Presented Component Units –**  
**Statement of Activities**  
**Year ended June 30, 2007**  
(In thousands)

Component units	Expenses	Program revenues		Net revenues (expenses) and changes in net assets	General revenues					Change in net assets	Net assets, beginning of year (as restated)	Net assets, end of year
		Charges for services	Operating grants and contributions	Capital grants and contributions	Payments from primary government	Payments from other component units	Contributions not restricted to specific programs	Taxes	Interest and investment earnings	Gain in sale of assets		
Nonmajor:												
Agricultural Services and Development Corporation	170,304	72,838	—	—	97,415	—	—	—	24,943	—	(107,674)	(106,881)
Automobile Accidents Compensation Administration	109,068	79,708	—	—	—	—	—	—	—	—	37,225	32,808
Cardiovascular Center Corporation of Puerto Rico and the Caribbean	75,108	67,310	—	—	2,500	—	—	—	291	—	(32,889)	(37,896)
Caribbean Basin Projects Financing Authority	103	—	—	—	—	—	—	—	4	—	(99)	—
Culebra Conservation and Development Authority	848	240	10	—	589	—	—	—	—	—	1,187	1,178
Economic Development Bank for Puerto Rico	66,482	66,794	—	—	—	—	—	—	4,725	—	118,900	123,937
Employment and Training Enterprises Corporation	3,680	2,338	210	—	—	—	—	—	95	5	(1,032)	(7,066)
Farm Insurance Corporation of Puerto Rico	8,169	9,102	2,003	—	—	—	—	—	247	98	6,207	9,488
Fine Arts Center Corporation	5,528	2,410	—	—	5,403	—	—	—	267	—	21,064	23,616
Governing Board of the 911 Service	17,728	21,292	—	—	—	—	—	—	1,934	497	5,995	36,170
Institute of Puerto Rican Culture	26,794	19,708	—	369	23,860	—	—	—	—	—	(2,565)	78,515
Institutional Trust of the National Guard of Puerto Rico	8,595	19,708	—	—	—	—	—	6,697	3,100	—	14,213	86,432
Land Authority of Puerto Rico	33,785	29,106	—	—	5,530	9,690	—	210	1,845	—	16,994	122,219
Musical Arts Corporation	8,264	449	892	—	—	—	—	—	—	—	(838)	(990)
National Parks Company of Puerto Rico	45,320	12,555	—	—	24,655	—	—	—	1,742	—	(3,702)	240,010
Puerto Rico Corporation for the Supervision and Deposit Insurance	9,543	12,789	—	629	—	—	—	—	7,972	—	11,847	138,021
Puerto Rico Convention Center Corporation	7,319	2,322	78	—	4,571	—	—	—	—	—	(336)	44,144
Puerto Rico Convention Center District Authority	82,047	28,500	—	—	39,500	—	—	30,582	4,718	—	112,335	134,392
Puerto Rico Council on Higher Education	34,231	183	3,789	—	27,091	—	—	—	581	—	(2,540)	7,105
Puerto Rico Industrial Development Company	86,259	64,231	—	207	3,434	—	—	—	6,558	21,370	414,677	424,218
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	61	—	—	—	—	—	—	—	389	—	328	8,480
Puerto Rico Land Administration	9,978	9,338	—	—	—	—	—	—	5,745	—	8,152	247,093
Puerto Rico Medical Services Administration	164,675	112,784	—	—	38,460	—	—	—	838	282	241,705	247,093
Puerto Rico Metropolitan Bus Authority	83,070	31,665	13,262	—	26,761	—	—	—	—	—	(48,264)	(58,971)
Puerto Rico Municipal Finance Agency	86,697	—	—	—	—	—	—	—	—	—	(11,375)	7,805
Puerto Rico Ports Authority	195,389	146,368	—	14,413	—	—	—	—	96,375	—	60,194	69,872
Puerto Rico Public Broadcasting Corporation	29,737	1,820	—	—	25,295	—	—	—	2,335	—	296,023	289,521
Puerto Rico School of Plastic Arts	5,959	911	1,221	—	3,503	—	3,068	—	400	521	23,721	25,088
Puerto Rico Solid Waste Authority	22,885	1,105	—	—	40,017	992	—	—	1,114	107	9,920	9,696
Puerto Rico Telephone Authority	502	—	—	—	—	—	—	—	516	—	100,617	121,067
Puerto Rico Tourism Company	324,337	323,293	—	—	3,033	(62,615)	—	21,347	8,161	14	7,003	7,017
Puerto Rico Trade and Export Company	44,785	17,239	—	—	9,744	—	—	—	19,991	2,413	25,194	(3,511)
Right to Employment Administration	29,886	—	16,283	4,775	13,677	—	—	—	332	7,107	131,127	138,234
Special Communities Perpetual Trust	135,844	—	—	—	50,266	—	—	—	27,744	406	(2,527)	(2,121)
State Insurance Fund Corporation	666,126	653,405	—	—	—	—	—	—	129,061	—	713,883	830,223
Total nonmajor component units	\$ 2,621,106	\$ 1,790,211	\$ 37,748	\$ 20,393	\$ 445,345	\$ (51,933)	\$ 3,068	\$ 58,836	\$ 352,142	\$ 25,669	\$ 2,718,128	\$ 2,813,684

See accompanying independent auditors' report.

## **STATISTICAL SECTION**

## STATISTICAL SECTION

This part of the Commonwealth of Puerto Rico's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the Commonwealth's overall financial health.

Contents	Pages
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Financial Trends	1 – 4
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These schedules contain trend information to help the reader understand how the Commonwealth's financial performance and well-being have changed over time.

Revenue Capacity	5
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This schedule contains information to help the reader assess the Commonwealth's most significant local revenue sources.

Debt Capacity	6 – 7
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These schedules present information to help the reader assess the affordability of the Commonwealth's current levels of outstanding debt and the Commonwealth's ability to issue additional debt in the future.

Demographic and Economic Information	8 – 10
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These schedules offer demographic and economic indicators to help the reader understand the environment within which the Commonwealth's financial activities take place.

Operating Information	11
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This schedule contains service data to help the reader understand how the information in the Commonwealth's financial report relates to the services the government provides and the activities it performs.

Sources: Unless otherwise noted, the information in these schedules is derived from the comprehensive annual financial reports for the relevant year.

**COMMONWEALTH OF PUERTO RICO**

Changes in Net Assets (Unaudited)

Last Four Fiscal Years

Accrual Basis of Accounting

(In thousands)

	2007	2006	2005	2004
Expenses:				
Governmental activities:				
General government	\$ 2,847,596	2,844,494	1,827,816	1,963,879
Public safety	1,983,782	2,217,294	2,580,951	1,950,635
Health	1,943,582	1,422,813	2,364,110	2,386,735
Public housing and welfare	3,157,877	3,287,559	3,443,886	2,919,315
Education	4,748,008	4,110,669	5,000,686	3,684,331
Economic development	554,271	564,447	1,006,945	896,925
Intergovernmental	593,264	440,390	—	591,237
Interest and other	863,723	882,163	845,556	778,700
Total governmental activities	<u>16,692,103</u>	<u>15,769,829</u>	<u>17,069,950</u>	<u>15,171,757</u>
Business-type activities:				
Lotteries	679,274	670,425	699,407	731,344
Unemployment	192,484	207,483	197,967	142,652
Other	26,860	25,043	32,437	26,763
Total business-type activities	<u>898,618</u>	<u>902,951</u>	<u>929,811</u>	<u>900,759</u>
Total primary government expenses	<u>17,590,721</u>	<u>16,672,780</u>	<u>17,999,761</u>	<u>16,072,516</u>
Program revenue:				
Governmental activities:				
Charges for services	757,724	828,993	702,691	769,207
Operating grants and contributions	4,773,174	4,365,711	4,096,204	1,038,776
Capital grants and contributions	257,514	100,990	121,083	2,592,055
Total governmental activities	<u>5,788,412</u>	<u>5,295,694</u>	<u>4,919,978</u>	<u>4,400,038</u>
Business activities:				
Charges for services	1,140,539	1,149,426	1,187,009	1,136,705
Operating grants and contributions	43,480	59,613	22,315	59,728
Total business-type activities	<u>1,184,019</u>	<u>1,209,039</u>	<u>1,209,324</u>	<u>1,196,433</u>
Net (expense) revenue:				
Governmental activities	(10,903,691)	(10,474,135)	(12,149,972)	(10,771,719)
Business-type activities	285,401	306,088	279,513	295,674
Total primary government net expense	<u>\$ (10,618,290)</u>	<u>(10,168,047)</u>	<u>(11,870,459)</u>	<u>(10,476,045)</u>
General revenue:				
Governmental activities:				
Taxes:				
Income	\$ 6,488,211	6,255,391	5,526,006	5,191,080
Excise	1,475,311	2,013,998	2,101,216	1,924,610
Sales and use tax	583,639	—	—	—
Other	4,663	15,145	7,128	19,211
Revenue from global settlement agreement	69,604	66,796	106,521	70,420
Unrestricted investment earnings	176,674	117,080	116,686	60,585
Revenue from component units	311,732	68,745	474,069	175,729
Grants and contributions not restricted to specific programs	135,916	196,721	102,691	5,706
Payment from agency fund	—	—	—	—
Special item	—	(2,485)	—	(35,646)
Gain on sale of assets	—	19,588	—	—
Transfers	342,743	242,642	492,796	203,258
Other	71,187	203,525	322,185	384,719
Total governmental activities	<u>9,659,680</u>	<u>9,197,146</u>	<u>9,249,298</u>	<u>7,999,672</u>
Business-type activities:				
Unrestricted investments earnings	37,177	33,165	32,284	23,831
Revenue from component units	—	—	—	—
Grants and contributions not restricted to specific programs	—	—	—	—
Transfers	(342,743)	(242,642)	(492,796)	(203,258)
Total business-type activities	<u>(305,566)</u>	<u>(209,477)</u>	<u>(460,512)</u>	<u>(179,427)</u>
Total primary government	<u>9,354,114</u>	<u>8,987,669</u>	<u>8,788,786</u>	<u>7,820,245</u>
Change in net assets:				
Governmental activities	(1,244,011)	(1,276,989)	(2,900,674)	(2,772,047)
Business-type activities	(20,165)	96,611	(180,999)	116,247
Total primary government	<u>\$ (1,264,176)</u>	<u>(1,180,378)</u>	<u>(3,081,673)</u>	<u>(2,655,800)</u>



**COMMONWEALTH OF PUERTO RICO**

Net Assets by Component (Unaudited)

Last Four Fiscal Years

Accrual Basis of Accounting

(In thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Governmental activities:				
Invested in capital assets, net of related debt	\$ 3,635,271	3,485,882	3,774,098	3,133,230
Restricted	331,051	280,078	296,692	—
Unrestricted deficit	<u>(22,405,216)</u>	<u>(20,975,523)</u>	<u>(19,987,579)</u>	<u>(16,789,576)</u>
Total governmental activities net assets	<u>(18,438,894)</u>	<u>(17,209,563)</u>	<u>(15,916,789)</u>	<u>(13,656,346)</u>
Business-type activities:				
Invested in capital assets, net of related debt	674	1,008	847	1,672
Restricted	910,479	947,507	872,215	853,194
Unrestricted deficit	<u>(153,818)</u>	<u>(171,015)</u>	<u>(202,212)</u>	<u>(3,037)</u>
Total business-type activities net assets	<u>757,335</u>	<u>777,500</u>	<u>670,850</u>	<u>851,829</u>
Primary government:				
Invested in capital assets, net of related debt	3,635,945	3,486,890	3,774,945	3,134,902
Restricted	1,241,530	1,227,585	1,168,907	853,194
Unrestricted deficit	<u>(22,559,034)</u>	<u>(21,146,538)</u>	<u>(20,189,791)</u>	<u>(16,792,613)</u>
Total primary government net assets	<u>\$ (17,681,559)</u>	<u>(16,432,063)</u>	<u>(15,245,939)</u>	<u>(12,804,517)</u>

**COMMONWEALTH OF PUERTO RICO**  
Changes in Fund Balances of Governmental Funds (Unaudited)

All Governmental Fund Types  
Last Ten Fiscal Years  
(In thousands)

	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
<b>Revenue:</b>										
<b>Taxes:</b>										
Income	\$ 6,389,973	6,181,995	5,564,673	5,061,761	4,874,795	4,843,852	4,536,840	4,967,138	4,413,860	3,989,239
Excise	1,475,311	2,013,998	2,101,216	1,924,610	1,894,729	1,713,098	1,788,992	1,736,539	1,714,444	1,884,348
Sales and use tax	583,639	—	—	—	—	—	—	—	—	—
Other	4,663	15,145	7,128	19,211	3,055	1,963	92,024	87,523	78,926	73,426
Charges for services	757,724	828,993	702,691	750,978	780,905	535,423	645,806	617,020	457,454	569,096
Intergovernmental	5,166,604	4,663,422	4,319,977	3,654,766	4,107,706	3,634,358	3,807,049	2,971,528	3,417,647	3,009,169
Interest	176,674	117,080	116,686	58,914	85,565	90,940	67,020	91,525	97,880	116,030
Other	434,024	334,591	869,338	629,426	436,668	839,240	270,711	383,548	162,228	189,476
<b>Total revenue all governmental fund types</b>	<b>14,988,612</b>	<b>14,155,224</b>	<b>13,681,709</b>	<b>12,099,666</b>	<b>12,183,423</b>	<b>11,658,874</b>	<b>11,208,442</b>	<b>10,854,821</b>	<b>10,342,439</b>	<b>9,830,784</b>
<b>Expenditures:</b>										
General government	2,537,999	2,489,093	1,675,428	1,777,365	1,774,156	1,279,750	739,009	853,040	526,629	484,547
Public safety	1,864,256	2,108,152	2,409,668	1,765,199	1,424,846	1,639,280	1,623,362	1,310,322	1,103,606	1,241,762
Health	1,948,201	1,429,888	2,344,522	2,176,741	1,908,717	1,983,727	954,563	972,757	625,475	656,498
Public housing and welfare	3,048,585	3,130,373	3,320,849	2,738,016	2,953,189	2,726,129	2,315,899	2,102,410	2,485,092	1,902,902
Education	4,400,321	4,101,980	4,177,664	3,474,013	3,297,248	3,343,002	2,308,479	2,436,267	2,272,903	2,744,630
Economic development	533,253	516,444	706,066	868,926	428,621	637,794	170,937	337,255	314,897	186,296
Intergovernmental	593,247	409,727	—	528,829	465,699	466,169	222,721	373,016	318,664	55,739
Capital outlays	512,824	502,348	665,630	581,788	1,184,976	507,634	1,020,344	833,597	642,016	1,515,230
Debt service:										
Principal	904,604	446,281	391,554	526,572	330,346	2,062,059	466,467	416,369	351,722	620,866
Interest and other	814,723	822,234	733,931	737,502	1,158,749	614,347	545,001	444,595	442,614	595,053
<b>Total expenditures all governmental fund types</b>	<b>17,158,013</b>	<b>15,956,520</b>	<b>16,425,312</b>	<b>15,174,951</b>	<b>14,926,547</b>	<b>15,279,891</b>	<b>10,366,782</b>	<b>10,079,628</b>	<b>9,083,618</b>	<b>10,003,523</b>
<b>Other financing sources (uses):</b>										
Transfers in	1,918,567	1,423,240	1,745,992	1,034,090	1,664,278	966,935	756,229	1,026,581	992,667	1,116,455
Transfers out	(1,575,824)	(1,180,598)	(1,253,216)	(830,832)	(1,385,218)	(779,752)	(2,864,056)	(2,646,732)	(2,841,330)	(2,156,852)
Long-term debt issued	1,140,356	1,518,355	1,619,562	3,001,116	2,241,190	3,107,821	834,396	474,471	479,610	1,971,960
Discount on bonds issued	—	(323)	(6,078)	(23,061)	(36,204)	(16,075)	—	—	—	—
Capital leases	2,975	4,580	847	2,300	58,897	—	—	—	—	—
Refunding bonds issued	379,498	—	—	2,372,689	1,754,686	1,636,838	329,370	54,645	117,529	631,906
Payment to refunded bond escrow agent	—	—	—	(2,316,910)	(1,754,686)	(1,665,811)	(227,369)	(54,645)	(117,529)	(632,822)
Other	—	54,135	—	—	—	327,785	—	—	—	140,000
<b>Total other financing sources (uses) all governmental fund types</b>	<b>1,865,572</b>	<b>1,819,389</b>	<b>2,107,107</b>	<b>3,239,392</b>	<b>2,542,943</b>	<b>3,577,741</b>	<b>(1,171,430)</b>	<b>(1,145,680)</b>	<b>(1,369,053)</b>	<b>1,070,647</b>
<b>Net change in fund balances (deficit)</b>	<b>\$ (303,829)</b>	<b>18,093</b>	<b>(636,496)</b>	<b>164,107</b>	<b>(200,181)</b>	<b>(43,276)</b>	<b>(329,770)</b>	<b>(370,487)</b>	<b>(110,232)</b>	<b>897,908</b>

The annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation, collected by the Municipal Revenue Collection Center on the Commonwealth's behalf, is presented as property tax from 2002 henceforth but as intergovernmental revenue in prior years.

In 2002, the Commonwealth adopted GASB No. 34. This statement requires that component units be included as expenditure by function. In prior years, such payments were reported as operating transfers-out to component units.

**COMMONWEALTH OF PUERTO RICO**  
Fund Balances of Governmental Funds (Unaudited)  
Last Four Fiscal Years  
Modified-Accrual Basis of Accounting  
(In thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
General fund:				
Reserved	\$ 993,320	770,628	810,314	1,102,232
Unreserved deficit	<u>(1,504,478)</u>	<u>(1,154,383)</u>	<u>(1,321,585)</u>	<u>(1,468,182)</u>
Total general fund	<u>\$ (511,158)</u>	<u>(383,755)</u>	<u>(511,271)</u>	<u>(365,950)</u>
All other governmental funds:				
Reserved	\$ 125,756	73,346	45,546	72,455
Unreserved reported in:				
Debt service funds	131,782	143,732	156,564	119,830
Special revenue funds	137,286	358,452	256,949	449,455
Capital project funds	<u>223,443</u>	<u>219,163</u>	<u>437,923</u>	<u>744,577</u>
Total all other governmental funds	<u>\$ 618,267</u>	<u>794,693</u>	<u>896,982</u>	<u>1,386,317</u>

**COMMONWEALTH OF PUERTO RICO**  
General Fund Net Revenue for the Last Ten Fiscal Years (Unaudited)  
(in thousands)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>\$</b>										
Administrative measures	—	—	—	—	244,097	—	—	—	—	—
Excises on off-shore shipments rum	200,260	217,296	245,750	286,890	314,253	309,958	328,921	341,166	346,272	377,872
Custom duties	72,206	61,355	50,231	43,154	30,595	25,918	34,266	26,731	9,553	14,504
From noninternal revenues	272,466	278,651	295,981	330,044	344,848	335,876	363,187	367,897	355,825	392,376
Miscellaneous	158,568	176,669	169,246	210,665	238,116	314,857	379,501	430,534	331,803	330,064
Transfer from nonbudgeted funds	—	—	—	89,093	80,000	123,600	—	—	—	—
Electronic lottery	54,681	53,013	70,209	70,211	57,897	89,443	86,115	68,011	55,212	71,815
Traditional lottery	57,986	59,206	63,779	57,482	61,358	67,621	65,387	64,638	62,729	73,014
Non-tax revenues	271,235	288,888	303,234	427,451	437,371	595,521	531,003	563,183	449,744	474,893
Alcoholic beverages and others	12,572	14,832	14,123	15,182	14,805	13,518	14,200	14,528	14,804	15,179
Entertainment machines	7,327	9,235	10,545	11,322	12,874	13,932	14,393	15,019	16,981	16,930
Motor vehicles	46,268	46,781	49,133	49,834	54,896	58,426	55,638	55,669	59,525	65,501
Licenses	66,167	70,848	73,801	76,338	82,575	85,876	84,231	85,216	91,310	97,610
Others	13,271	17,273	15,194	16,686	64,626	20,539	24,334	29,927	25,681	20,235
Hotel rooms	13,299	15,923	17,275	—	—	9,056	—	—	—	—
5% general excise tax	468,425	520,351	525,561	508,972	486,302	505,709	535,381	557,323	551,723	193,949
Crude oil and derived products	51,636	70,056	24,786	1,901	38,619	12,925	—	—	—	—
Slot machines	12,230	26,330	30,869	—	36,953	90,018	76,966	85,513	23,167	23,128
Cement	1,702	2,417	2,531	2,707	3,426	3,279	3,432	3,228	2,919	2,627
Insurance premiums	19,364	20,368	21,564	22,845	24,290	26,771	27,217	28,324	43,055	39,052
Horse races	27,401	21,405	26,351	18,893	22,033	28,872	28,865	31,463	30,786	29,321
Motor vehicle	350,004	411,573	389,995	406,252	418,024	499,252	551,181	606,662	533,957	396,667
Petroleum products	6,172	5,562	4,689	7,046	5,095	5,860	4,934	5,143	5,146	6,028
Cigarettes	111,094	119,105	115,157	119,135	116,055	149,487	144,733	146,527	135,267	132,399
General taxes, total	1,074,598	1,230,363	1,173,972	1,104,437	1,215,423	1,351,768	1,397,043	1,494,110	1,351,701	843,406
Other beverages	11,619	14,597	16,884	13,101	18,234	17,884	17,428	19,692	18,745	18,932
Beer	178,465	181,348	170,065	177,448	179,737	223,309	217,568	221,902	219,379	207,813
Distilled spirits	48,034	47,519	49,425	46,963	51,734	58,389	61,306	56,641	54,056	52,283
Alcoholic beverages, total	238,118	243,464	236,374	237,512	249,705	299,582	296,302	298,235	292,180	279,028
Excise taxes, total	1,312,716	1,473,827	1,410,346	1,341,949	1,465,128	1,651,350	1,693,345	1,792,345	1,643,881	1,122,434
Sales and use tax	—	—	—	—	—	—	—	—	—	582,560
Inheritance and gift taxes	1,380	1,811	3,109	7,475	1,962	2,825	15,691	7,129	9,466	4,563
Taxes on dividends to 10%	39,616	38,996	39,664	58,580	62,548	49,790	70,192	80,398	66,721	138,859
Interest subject to 17%	11,406	10,666	11,674	14,782	14,310	11,278	10,108	10,489	11,536	12,112
Tollgate tax	170,953	114,533	111,130	49,511	59,515	45,321	31,579	22,973	27,396	25,083
Withholding to nonresidents	192,463	369,384	557,276	696,835	583,256	517,141	631,100	612,005	921,260	933,728
Partnerships	4,404	2,087	2,339	3,026	2,670	2,101	3,005	3,245	2,787	2,960
Corporations	1,527,415	1,653,762	1,781,862	1,696,766	1,706,137	1,776,985	1,831,027	1,870,937	1,872,458	2,002,718
Individuals	2,026,612	2,244,376	2,352,066	2,259,090	2,445,982	2,767,678	2,720,920	2,885,903	3,087,748	3,071,655
Income taxes, total	3,972,869	4,433,804	4,856,011	4,778,590	4,878,418	5,170,294	5,297,931	5,485,950	5,989,906	6,187,115
Property taxes	5,673	2,214	1,131	287	—	—	—	3,949	1,106	800
Tax revenues	5,558,805	5,982,504	6,344,398	6,204,639	6,428,083	6,910,345	7,091,198	7,374,589	7,735,669	7,995,182
From internal revenues	5,630,040	6,271,392	6,647,632	6,632,090	6,865,454	7,505,866	7,622,201	7,937,772	8,185,413	8,470,075
Total	\$ 5,902,506	\$ 6,550,043	\$ 6,943,613	\$ 6,962,134	\$ 7,454,399	\$ 7,841,742	\$ 7,985,388	\$ 8,305,669	\$ 8,541,238	\$ 8,862,451

Note: The net revenue presented above include the actual revenue and the operating transfers-in from other funds presented in the combined statement of revenue and expenditures – budget and actual – budget basis.  
Source: Puerto Rico Treasury Department

**COMMONWEALTH OF PUERTO RICO**  
**Legal Debt Margin Information (Unaudited)**  
Last Ten Fiscal Years  
(In thousands)

	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Internal revenue average for two years	\$ 8,327,744	\$ 8,061,593	7,779,987	7,564,034	7,185,660	6,748,772	6,639,861	6,459,512	5,950,716	5,482,960
Legal debt limit – 15% of internal revenue average for two years	1,249,162	1,209,239	1,166,998	1,134,605	1,077,849	1,012,316	995,979	968,927	892,607	822,444
Maximum debt service requirement	719,927	680,742	630,685	598,547	599,611	521,035	588,359	561,918	532,324	533,241
Additional legal debt service requirement margin	—	—	536,313	536,058	478,238	491,281	40,762	407,009	360,283	289,203
Total maximum debt service requirement as a percentage of internal revenue average for two years	8.64%	8.44%	8.11%	7.91%	8.34%	7.72%	8.86%	8.70%	8.95%	9.73%
Legal debt margin calculation for fiscal year 2007:										
Internal revenue for the year ended June 30, 2006		\$ 8,185,413								
Internal revenue for the year ended June 30, 2007		\$ 8,470,075								
Total internal revenue for the years ended June 30, 2006 and 2007		\$ 16,655,488								
Internal revenue average for the two years		\$ 8,327,744								
Legal debt limit – 15% of internal revenue average for the two years		\$ 1,249,162								
Maximum debt service requirement		\$ 719,927								
Additional legal debt service requirement as a percentage of internal revenue average for two years		\$ 529,235								

Sources: Governmental Development Bank for Puerto Rico General obligation debt service may not exceed 15% of the average of the internal revenues for the last two fiscal years.

# COMMONWEALTH OF PUERTO RICO

## Ratio of Annual Debt Service for General Bonded Debt to Total General Expenditures (Unaudited)

Last Ten Fiscal Years

(In thousands)

	<b>Total debt service</b>	<b>Total governmental expenditures</b>	<b>Ratio</b>
Fiscal year:			
2007	\$ 606,800	17,158,013	3.5%
2006	565,137	15,849,707	3.6
2005	491,394	16,425,312	3.0
2004	459,336	15,174,951	3.0
2003	362,136	14,926,547	2.4
2002	608,674	15,279,891	4.0
2001	538,436	10,366,782	5.2
2000	507,336	10,079,628	5.0
1999	468,970	9,083,618	5.2
1998	435,894	10,003,523	4.4

# COMMONWEALTH OF PUERTO RICO

Demographic and Economic Statistics (Unaudited)

Last Ten Fiscal Years

Fiscal year:	Population *	Per capita income	Median age	Life expectancy	School enrollment (r)	Labor force (in thousands)	Unemployment rate	Gross product (current prices \$)**	Real gross product (2000 prices \$)**
2007	3,941	\$ 13,491(p)	34.4	76.8	716,755	1,409	10.4	\$ 58,712(p)	\$ 44,213(p)
2006	3,928	13,033(r)	34.4	76.8	774,381	1,422(r)	11.7	56,733(r)	45,009(r)
2005	3,912	12,507(r)	34.4	76.8	786,819	1,385	10.6	53,752(r)	44,785(r)
2004	3,895	11,724	33.8	76.8	715,615	1,360	11.4	50,709	43,950(r)
2003	3,879	11,429	33.3	76.8	776,095	1,352	12.1	47,479	42,795
2002	3,859	10,921	32.9	75.2	753,317	1,309	12.1	45,071	41,901
2001	3,840	10,732	32.6	74.0	816,057	1,278	10.5	44,047	42,044
2000	3,816	10,204	32.2	74.0	745,513	1,292	11.0	41,419	41,419
1999	3,800	9,659	31.8	75.0	749,192	1,306	12.5	38,281	40,225
1998	3,781	9,108	31.4	73.0	726,898	1,318	13.7	35,111	38,658

Source: Puerto Rico Planning Board, Department of Education, Department of Labor and Human Resources, and General Council of Education of the Commonwealth of Puerto Rico. The enrollment in private schools is an estimate.

\* Population as of July 1 (in thousands).

\*\* Amounts expressed in millions.

(p) Preliminary figures.

(r) Revised figures.

**COMMONWEALTH OF PUERTO RICO**

Average Employment by Sector (Unaudited)

Last Ten Fiscal Years

(In thousands)

Sector	2007 (p)	2006 (r)	2005 (r)	2004 (r)	2003 (r)	2002 (r)	2001 (r)	2000 (r)	1999 (r)	1998 (r)
Agriculture	16	22	26	25	24	23	21	24	27	31
Manufacturing	135	136	138	136	134	137	157	158	159	161
Mining		a/							a/	
Construction	94	88	87	88	82	84	84	84	78	69
Trade	260	271	261	253	252	236	239	237	228	236
Finance, insurance, and real estate	45	46	43	41	42	42	39	42	42	40
Transportation, communications, and public utilities	53	58	59	55(r)	57	62	56	55	59	59
Services	364	355	349	340	328	311	298	304	306	297
Government (1)	296	280	274	268	269	257	248	247	245	245
Total (2)	1,263	1,256	1,238	1,151	1,188	1,152	1,142	1,151	1,144	1,138

(p) Preliminary figures.

a/ Less than 2,000.

(r) Figures revised in accordance with the Census of Population and Housing of 2000.

(1) Includes the Commonwealth, its municipalities, and federal government, and excludes public corporations.

Sources: Puerto Rico Department of Labor and Human Resources, Household Survey, and Puerto Rico Planning Board.

(2) Totals may not add due to rounding.



COMMONWEALTH OF PUERTO RICO

Tourism Indicators (Unaudited)  
Last Ten Fiscal Years

	2007 (p)	2006 (r)	2005	2004	2003	2002	2001	2000	1999	1998
All hotels and hostelry registration	2,049,839	2,160,455(r)	2,097,606	2,008,730	1,964,963	1,821,274	1,836,377	1,674,092	1,637,620	1,570,683
Occupancy rates	68.4%	67.9%	67.7%	68.9%	64.9%	67.8%	66.7%	70.7%	71.9%	67.3%
Number of rooms	13,600	13,577	13,459	12,864	12,788	12,768	12,353	11,928	11,102	11,848
Visitors' expenditures*	\$ 3,414	3,369	3,239	3,024	2,677	2,486	2,728	2,388	2,139	2,233

\* Amounts expressed in millions of dollars.

(p) Preliminary figures.

(r) Revised figures.

Sources: Puerto Rico Tourism Company and Puerto Rico Planning Board.

**COMMONWEALTH OF PUERTO RICO**  
Operating Indicators by Function (Unaudited)  
Last Ten Fiscal Years

Function	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
<b>Fire protection:</b>										
Number of stations	94	94	94	98	93	93	92	96	92	91
Fire personnel and officers	2,232	2,233	2,233	1,851	1,894	1,867	1,852	1,818	2,004	2,004
Calls answered	10,441	10,435	11,514	10,716	12,340	13,256	14,271	31,681	28,575	23,299
Building inspections conducted	73,478	73,360	71,610	56,093	53,750	41,415	31,693	44,396	14,621	30,139
<b>Police protection:</b>										
Number of stations	238	238	234	231	228	235	239	238	236	234
Police personnel and officers	19,069	20,552	20,806	21,185	21,079	20,468	20,800	20,822	20,305	19,934
Calls answered	7,101	7,146	7,178	6,907	5,538	4,673	4,957	5,059	4,545	4,748
<b>Water system:</b>										
Customers	1,290,497	1,285,732	1,251,699	1,256,981	1,238,461	1,209,834	1,195,038	1,179,109	1,163,673	1,148,284
Water consumption (millions of cubic meters)	350	365	356	359	350	349	348	350	348	343
<b>Electric distribution system:</b>										
Customers	1,452,529	1,450,227	1,438,699	1,419,602	1,401,301	1,383,888	1,365,668	1,344,907	1,326,055	1,309,954
Electricity consumption (millions of kilowatt)	20,672	20,620	20,507	20,260	19,887	19,130	18,723	18,144	16,989	17,457
Electricity production (millions of kilowatt)	25,082	24,870	24,500	24,100	23,717	22,514	22,132	21,461	20,140	20,725
<b>Education:</b>										
Enrollment in public schools:										
Kindergarten to sixth grade	293,796	306,073	323,270	321,653	326,606	334,929	341,467	341,470	350,714	354,098
Seventh to ninth grade	133,171	135,166	137,717	142,305	146,896	146,837	145,858	145,908	144,157	143,382
Tenth to twelfth grade	117,400	122,251	118,491	116,829	118,519	117,072	119,162	118,498	114,684	111,798
Enrollment in private schools:										
Kindergarten to sixth grade	105,724	124,483(r)	128,645(r)	83,548(r)	117,622	98,719(r)	135,655(r)	90,577(r)	90,577(r)	75,169(r)
Seventh to ninth grade	35,437	44,140(r)	41,888(r)	27,612(r)	37,226	31,245(r)	41,273(r)	27,366(r)	27,366(r)	23,777(r)
Tenth to twelfth grade	31,227	42,268(r)	36,808(r)	23,668(r)	29,226	24,515(r)	32,642(r)	21,694(r)	21,694(r)	18,674(r)
Enrollment in universities and colleges:										
Public	66,990	68,813	71,044	74,056	74,801	73,974	73,846	73,846	72,010	70,765
Private	158,412	140,734	136,650	132,735	125,041	117,578	100,704	100,704	103,623	101,020

Source: Various agencies and component units of the Commonwealth of Puerto Rico. The enrollment in private schools is an estimate.